ILLINOIS COALITION LAUNCHES ANTI-TAX CAMPAIGN 4
MASSACHUSETTS CONSIDERS STATE INCOME TAX CUT 7
FREEDOM 10-11

Budget&Tax News

©2004 THE HEARTLAND INSTITUTE | THE MONTHLY NEWSPAPER FOR TAX ISSUES | V2 N6 ~ JULY 2004

Congress Debates Limits on State Business Activity Taxes

by Chris Atkins

Congress is debating legislation that would limit state attempts to collect taxes from out-of-state businesses. A hearing before a subcommittee of the House Judiciary Committee in May revealed fierce opposition by state tax officials to the proposed limits, but also strong support from business spokespersons and advocates of federalism.

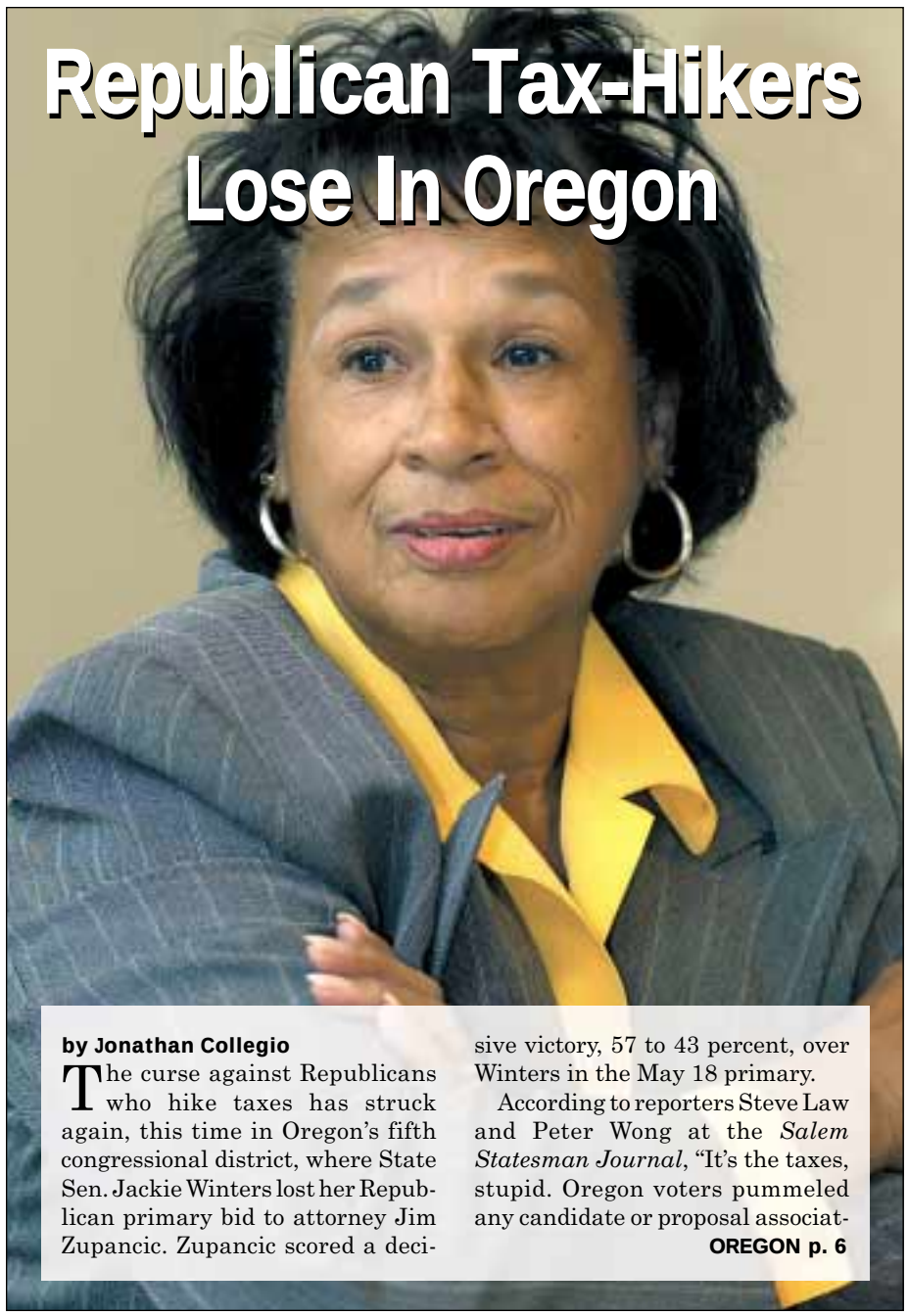
States Chasing Businesses

Louisiana has attempted to tax out-of-state media companies merely because they broadcast signals into Louisiana. The Alabama revenue department tried to tax a credit card company solely because it issued cards to customers in Alabama. A regulation in Oregon indicates the receipt of franchise fees or royalties from Oregon sources subjects a business to Oregon taxation, even if that business has no physical connection to the state.

Other states assert a business could be subject to taxation merely as a result of a truck passing through the state, a listing in a phone book, having a Web site on a server, having a bank account, or obtaining a loan.

C. J. Horne, owner of a small software company in South Carolina, recently got a tax bill from the state of New Jersey. Rev-

ACTIVITY p. 16



Republican Tax-Hikers Lose In Oregon

by Jonathan Collegio

The curse against Republicans who hike taxes has struck again, this time in Oregon's fifth congressional district, where State Sen. Jackie Winters lost her Republican primary bid to attorney Jim Zupancic. Zupancic scored a decisive victory, 57 to 43 percent, over Winters in the May 18 primary.

According to reporters Steve Law and Peter Wong at the *Salem Statesman Journal*, "It's the taxes, stupid. Oregon voters pummeled any candidate or proposal associat-

OREGON p. 6

Roll Call Photos

58 Million Wage Earners Pay No Federal Income Tax

by Scott A. Hodge

According to the Washington, DC-based Tax Foundation, "a record 44 million tax returns filed in 2005 will be correctly demanding the return of every dollar (or more) that is being withheld from their paychecks during 2004."

"In other words," said Tax Foundation economist J. Scott Moody, "after taking all the available credits and deductions, they will owe no income taxes and Uncle Sam may well owe them."

The number of zero-tax filers is growing rapidly because of the Bush tax cuts, the Tax Foundation reported. In 2000, 29 million people had no federal income tax liability; that figure will reach 44 million in 2004, a 50 percent increase. (See accompanying figure.)

"In addition to these zero-tax filers, roughly 14 million individuals and families will earn some income but not enough to be required to file a tax return,"

ZERO TAX p. 12

Unfunded Federal Mandates Surge Again

by Molly Stauffer and Carl Tubbesing

In the late 1980s, state legislators were "mad as hell" and they weren't going to take it anymore. They were angry about unfunded federal mandates. Democrats and Republicans alike railed against specific mandates, such as elements of the Safe Drinking Water Act and crumb rubber requirements in the highway law. And, more fundamentally, they viewed unfunded mandates as a sign of a troubling one-size-fits-all, top-down imbalance in the federal system.

UNFUNDED p. 3

IN THIS ISSUE

5 Kansas Rejects Tax Hikes
8 State Tap Private Prisons
11 State Budget Gaps Shrink
14 Three Cheers for Beer!
15 Mich. House Hikes Cigarette Tax
18 Who Determines Wal-Mart's Fate?

The Heartland Institute
19 South LaSalle #903
Chicago, IL 60603

PRESORTED
STANDARD
US POSTAGE PAID
BEAVER DAM, WI
PERMIT NO. 412

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

GAS TAXES

Reuters Live Photos

by John Skorburg

The nation's largest bipartisan, individual membership organization for state legislators is urging policymakers to give drivers relief at the pumps this summer by temporarily repealing state gas taxes.

"The states must take all appropriate actions to lower fuel costs," wrote Duane Parde, executive director of the Washington, DC-based American Legislative Exchange Council (ALEC), in a May 20 news release. "The average state levies a 24.3 cent tax on each gallon of gasoline. Temporarily repealing these taxes would be good for the bottom line of the family budget.

"The average price of a gallon of gasoline has skyrocketed ... While much blame is placed on the oil and gasoline companies, government also contributes to the high cost of fuel through taxes and regulation," noted Parde.

Oil Futures Soar

Prices of oil and gasoline in the futures market hit record highs on May 24, despite Saudi Arabia's pledge to increase production in June or July. The futures price of light crude oil for July delivery rose to $41.72 a barrel on the New York Mercantile Exchange, exceeding the previous record, $41.55, set just a week earlier.

Prices for wholesale gasoline for June delivery rose 4.1 cents to a record high $1.46, excluding state and federal gasoline taxes. That marked the highest wholesale price for gasoline since the contract began trading in 1984, 20 years ago.

U.S. gasoline supplies were reported at 203.7 million barrels on May 14, about 4 percent under the five-year average for the season. At the same time, demand for gasoline has increased 3 percent since the same period in 2003.

According to the Energy Information Administration, the average U.S. retail price for a gallon of unleaded gasoline was $1.94 on June 21. In California, the average price was $2.26, highest in the nation.

"The average state levies a 24.3 cent tax on each gallon of gasoline. Temporarily repealing these taxes would be good for the bottom line of the family budget."

DUANE PARDE
AMERICAN LEGISLATIVE EXCHANGE COUNCIL

"Until the fundamentals change, there's going to be upside pressure on prices," said Mike Harvey, an oil and gasoline analyst for ABN Amro Inc., based in New York.

"People aren't going to stop driving because prices are high," Harvey told the Chicago Tribune News Service on May 25. "People are going to drive. They've got to drive their kids to school or take their vacations."

Pennsylvania Responds

Pennsylvania lawmakers already have proposed measures to temporarily rollback the state tax on gasoline by 12 cents a gallon.

Reported Channel 6 news in Philadelphia, "State Senator Allyson Schwartz of Philadelphia and Representative Peter Daley of Washington County, both Democrats, say the current record-high price of gasoline not only forces Pennsylvanians to pay more to operate vehicles, but also inflates the cost of most consumer goods." In May, the two introduced similar gas tax reduction bills in the Senate and House.

Governor Ed Rendell (D) is lukewarm on the proposals. While Channel 6 reported on May 26 Rendell understands people are "frustrated over soaring fuel prices," the governor believes a tax rollback will have "little effect on prices at the pump." He also warned a gas tax break would "cut into revenues needed to maintain state highways and bridges."

The Schwartz and Daley proposals would cut the state tax on gasoline from 26 cents a gallon to 14 cents for as long as six months. The tax reduction would be suspended after three months if the average price of a gallon had fallen to less than $1.80.

"High gas prices create a massive drag on our economy, slowing the recovery and stifling job creation," said Schwartz.

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

Budget&Tax News
EDITORIAL OFFICES

The Heartland Institute

The Heartland Institute
19 South LaSalle Street #903
Chicago, Illinois 60603
312/377-4000 voice • 312/377-5000 fax

Budget & Tax News is available on the Internet. Point your web browser to **http://www.heartland.org**.

PUBLISHER
Joseph L. Bast

ASSOCIATE PUBLISHER
Nikki Saret

EDITOR
Diane Carol Bast

MANAGING EDITOR
John Skorburg
skorburg@heartland.org

DESIGN AND PRODUCTION
Kevin Fitzgerald, Ross Van Overberghe

ADVERTISING MANAGER
Nikki Saret

CIRCULATION MANAGER
Latreece Vankinscott

CONTRIBUTING EDITORS
Chris Atkins, Bruce Bartlett
John Berthoud, Sandra Fabry
Robert Genetski, Scott Hodge
Dan Mitchell, Steve Moore
Dan Pilla, Terry Savage
Geoffrey Segal, Bob Williams

BOARD OF DIRECTORS
Joseph Bast, Walt Buchholtz
Robert Buford, James Fitzgerald
Paul Fisher, Dan Hales
Willliam Higginson, James L. Johnston
Roy E. Marden, David H. Padden
Frank Resnik, Leslie Rose
Lee Tooman, Herbert J. Walberg Ph.D.
Lee H. Walker, Thomas Walton

ADVERTISING: *Budget & Tax News* accepts display advertising and advertising inserts. For an advertising kit with rate card and calendar, contact Associate Publisher Nikki Saret at 312/377-4000, e-mail nikki@heartland.org.

Budget & Tax News is published 10 times per year by The Heartland Institute. Subscriptions are $36 per year. Order online at www.heartland.org. Heartland is a nonprofit and nonpartisan public policy research organization serving the nation's federal and state elected officials, journalists, Heartland Members, and other opinion leaders. Its activities are tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

© 2004 The Heartland Institute. Nothing in this issue of *Budget & Tax News* should be construed as reflecting the views of The Heartland Institute, nor as an attempt to aid or hinder the passage of any legislation.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Unfunded

Continued from page 1

For several reasons, including passage of the federal Unfunded Mandate Reform Act (UMRA) in 1995, the firestorm of complaints about unfunded mandates largely abated during the latter half of the 1990s. Less than a decade later, however, unfunded mandates are back with a vengeance.

A new study released by the National Conference of State Legislatures (NCSL) in March indicates state governments in the current fiscal year are confronting at least $29 billion in cost shifts from the federal government—almost 6 percent of state general fund budgets. The figure is projected to rise to nearly $34 billion in FY 2005. The study confirmed what many legislators know from personal experience: The federal government is imposing numerous requirements, standards, and conditions on the states, but is not providing adequate funds to cover the costs.

"Even in good economic times," says Pennsylvania Representative David Steil (R-Bucks County), "costs like these are insidious. They cause state and local officials to cut services and to steal funds from worthy state programs to pay for federal ones. In bad economic times, these mandates are intolerable."

Despite a fourth consecutive year of projected state budget gaps, Congress continues to add to the problem, according to the latest issue of NCSL's *Mandate Monitor*.

Washington lawmakers have enacted or are considering nearly 50 bills during the 108th Congress that would leave states holding the bag. Medicare prescription drugs, special education, homeland security, and enforcement of federal immigration laws will all compound states' budget woes.

Over the past four fiscal years, states have been forced to deplete reserve accounts, reduce or eliminate programs, and increase fees and taxes in order to close a cumulative budget gap of more than $200 billion. Despite an improving economy, a recent NCSL report noted states still must close a $720 million collective budget gap for fiscal year 2004 and a $36 billion gap in fiscal year 2005. (See "State Budget Gaps Shrink, States report budget improvements," page 11.)

Previously enacted federally mandated cost shifts to states already account for at least $33 billion in fiscal year 2005. (See table.)

"Unfunded federal mandates are a growing concern to state legislators," said Steil, who chairs NCSL's Budgets and Revenue Committee. "As Washington struggles to address its own budget problems, their answer seems to be to pass the buck. Unfortunately, they're trying to get water from a stone—states literally have few resources left. The policy of pushing federal program costs to the states is irreconcilable with the partnership we share."

Molly Stauffer and Carl Tubbesing are on the staff of the National Conference of State Legislatures. Stauffer's email address is **molly.stauffer@ncsl.org**.
This report first appeared in the May 2004 issue of State Legislatures *magazine and is reprinted with permission.*
© 2004 National Conference of State Legislatures.

"Even in good economic times, costs like these are insidious. They cause state and local officials to cut services and to steal funds from worthy state programs to pay for federal ones. In bad economic times, these mandates are intolerable."

Pennsylvania State Representative David Steil (R-Bucks)

INTERNET INFO

For more information visit the Web site of the National Conference of State Legislatures at **http://www.ncsl.org**.

Federal Mandates on States Projected Cost, 2004 and 2005

Federally Mandated Program	Cost to States	
	FY 2004	FY 2005
Food Stamps	$197 million	$197 million
Help America Vote Act	$2.4 billion	$2.94 billion
Environment	$1 billion	$1.45 billion
No Child Left Behind	$9.6 billion	$10 billion
Individuals with Disabilities Education Act	$10 billion	$9 billion
State Criminal Alien Assistance Program	—-	$297 million
Transportation Sanctions	$19 million	$38 million
State Drug Costs for Dual-Eligibles	$6 billion	$6.6 billion
Medicaid	—-	$1.88 billion
Homeland Security	—-	$1.145 billion
Bioterrorism	—-	$105.5 million
Workers' Grants	—-	$161 million
TOTAL	$29.3 billion	$33.8 billion

Challenge the Status Quo...and Win!

Maureen Martin

"While collegial in manner and tone, Maureen Martin poignantly sends her messages with a unique clarity that convincingly stirs our thoughts."

MICHAEL D. SERMERSHEIM, UNIVERSITY OF AKRON

Maureen Martin, Senior Fellow for legal affairs at The Heartland Institute, is a veteran advocate for justice. She has written and spoken extensively on lawsuit abuse, litigation, tobacco control, and gun control.

Speaking engagements are scheduled on a "first come, first served" basis. **Call 312/377-4000** today to schedule Maureen Martin to keynote your next event!

The Heartland INSTITUTE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Illinois Coalition Launches Anti-Tax, Pro-Jobs Campaign

by Glenn Hodas

A group of Illinois business and civic organizations has come together in an effort to bring more jobs to the state by holding government accountable for the impact its tax-and-spend policies, especially fees charged to businesses, have on the state's economy.

Members of the Illinois Coalition for Jobs, Growth & Prosperity on May 5 unveiled a media campaign aimed at challenging Governor Rod Blagojevich (D) and lawmakers to consider the "negative impacts proposed tax and fee increases would have on Illinois jobs." The coalition requested a meeting with the governor in hopes of finding "common ground on the proposed budget for the sake of working men and women and the unemployed throughout the state."

As this issue of *Budget & Tax News* went to press, the governor had not responded to the request.

The state's budget for the coming fiscal year, which begins July 1, has at least a $1.5 billion deficit. State policymakers have yet to reach consensus on how to correct the situation.

Recovery Misses Illinois

"As a state, we have not responded quickly enough to the changing economic landscape, and therefore remain behind the U.S. and our neighboring states in job growth," said Gregory W. Baise, president and CEO of the Illinois Manufacturers Association, a member of the coalition.

"With the national economy showing signs of life," Baise continued, "we need to act today to carry this recovery to every Illinois county. Continuing the trend to tax and raise fees on employers impedes Illinois' opportunity of joining the recovery. With this media campaign, we urge the governor and lawmakers to show leadership and vision this month."

An analysis of 1990-2004 employment data, conducted for the coalition by the Regional Economics Applications Laboratory (REAL) of the University of Illinois, shows the state's employment growth rate lags the nation and the rest of the Midwest.

According to the REAL report, if Illinois began with its 1990 employment base and experienced employment growth at the national average, the state would have had 451,376 more jobs in 2003 and 455,482 more jobs in 2004. If Illinois had seen employment growth at only the Midwest average, the state would have had 263,064 more jobs in 2003 and 302,692 more jobs in 2004. According to REAL, the state's employment picture showed no trace of improvement in 2004.

Other states are actively recruiting Illinois businesses, many of whom have been hard hit by increases in employer fees and taxes imposed by Illinois lawmakers last year.

Bipartisan Effort

The coalition's television ads, which began airing in the state capital in early May, shed light on the shortcomings of Blagojevich's budget proposal, which coalition members warn will fuel job losses in the state. According to Jeffrey Mays, president and CEO of the Illinois Business Roundtable, Illinois workers can ill afford continued political bickering at this critical juncture in the nation's economic recovery.

The group has budgeted $450,000 to present its message throughout downstate Illinois. According to Douglas Whitley, president and CEO of the Illinois State Chamber of Commerce, the coalition will remain bipartisan in its advocacy efforts.

"While we're currently focusing our message on the governor's budget proposal, the overriding concern is creating an environment where Illinois employers can compete in the Midwest and elsewhere within the U.S.," Whitley explained. "No political party has a monopoly on wanting prosperity. People who are out of work just want things to get better, and they expect Springfield to help, not make matters worse."

The coalition inaugurated its public information campaign in early 2003 with bipartisan ads and telephone messages pointing out the pro-jobs voting records of Democratic State Representatives Lou Lang of Skokie, Arthur Turner of Chicago, and Patrick Verschoore of Milan, as well as Republicans Suzanne Bassi of Palatine and Robert Pritchard of Sycamore. The coalition also targeted the anti-employer voting record of State Representative Mike Boland of East Moline.

The coalition represents firms employing more than one million Illinois workers. The group's founding members are the Chicagoland Chamber of Commerce, Illinois Business Roundtable, Illinois Civil Justice League, Illinois Manufacturers Association, and Illinois State Chamber of Commerce.

In a May 26 article in the *Chicago Tribune*, a spokesperson for the governor's Office of Management and Budget, Becky Carroll, described the coalition, and specifically Whitley, as "fighting on behalf of special interests."

"People who dismiss Illinois' employment problems as 'special-interest' lobbying aren't in tune with what is happening to the real people in this state," Mays responded. "If our elected officials in Springfield want to help families, they'll find ways to live within their means, not continue to tax and fee people out of their jobs. In fact, job retention and creation is the special interest on the mind of every Illinois family."

Glenn Hodas is executive director of the Illinois Coalition for Jobs, Growth & Prosperity. His email address is **info@jobsillinois.us**.

INTERNET INFO

For more information visit the Coalition's Web site at **http://www.jobsillinois.us**.

The world's fastest, most complete, most reliable, and easiest-to-use source of policy research and commentary...

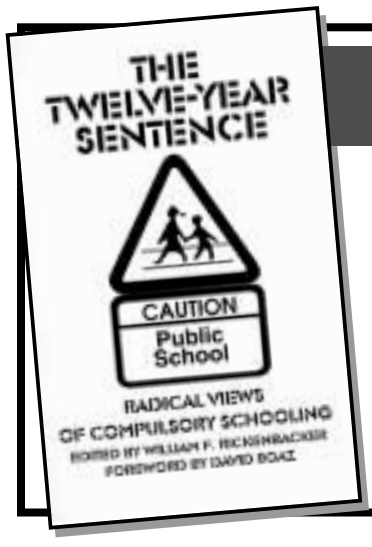
PolicyBot™

...is available to you FREE!

PolicyBot™ gives you free, instant access to the complete texts of more than 13,500 studies, reports, articles, and other documents on today's hottest public policy issues.

The information you need, when you need it.

PolicyBot™ @ www.heartland.org



Order Your Copy of The *Twelve-Year Sentence* Today!

Compulsory schooling has come under increasing fire from the educationalists themselves and from outside critics. From one end of the country to the other, the subject of schooling gives rise to bitter and endless controversy. These six papers give a better understanding of the origins of compulsory education and the alternatives available to parents.

The Twelve-Year Sentence - 236pp., $10.95

Order your copy today!

Contact The Heartland Institute at 312/377-4000, or order from the Heartland store at **www.heartland.org**

The Heartland INSTITUTE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Citizen Groups Hail Rejection of Tax Hikes in Kansas

by John Skorburg

On May 27, the Kansas legislature officially adjourned without passing a tax hike. A budget is in place for the coming fiscal year, though many questions remain concerning the future of the state's tax and spending plans.

"The Legislature ended the session deadlocked on whether to raise taxes for schools," reported the *Lawrence-Journal World* on May 28. "Now legislators—many of whom face re-election this fall—await a Kansas Supreme Court decision on a lower court ruling that said the state's school finance system was unconstitutional because it underfunded and shortchanged minority students."

"Taxpayers refused to suffer in silence for Topeka's excessive spending. The Governor and the Legislature should remember this message."

JOHN BERTHOUD, NATIONAL TAXPAYERS UNION

Praise from Taxpayer Advocates

The Kansas state legislature deserves "praise, not blame, for defeating a punitive new tax hike package that would have fueled more wasteful state spending," said John Berthoud, president of the 350,000-member National Taxpayers Union (NTU).

"Taxpayers refused to suffer in silence for Topeka's excessive spending," said Berthoud. "The Governor and the Legislature should remember this message."

"This battle is over and the taxpayers won. Sadly, despite this victory, the war continues," noted Karl Peterjohn, president of the Kansas Taxpayers Network, in a recent email message to supporters.

"After repeated school finance bills passed one house or the other, but not both, 165 legislators finally and rather quietly passed their omnibus appropriations bill and went home," continued Peterjohn.

School Funding Issue Remains

School funding legislation did not pass and remains an issue in Kansas. According to Peterjohn, the key session vote against raising taxes took place on May 14, when the state senate rejected by an 18 to 21 vote a proposal that would have hiked sales, income, and property taxes.

"This was the most votes the pro-tax senators could gather for a plan that raised state taxes roughly $129 million and millions more in local property taxes," he said. "There were 10 RINOs (Republicans in name only) who voted for this tax hike proposal and eight Democrats."

Kansas Governor Kathleen Sebelius (D)

Also on May 14, legislators considered a proposal that would have raised $82 million for elementary and secondary education by borrowing transportation funds. Governor Kathleen Sebelius (D) "labeled the idea the height of irresponsibility," according to television news reports. The senate nevertheless approved the measure by a 26-10 vote. The house rejected it 75-41. "We just ran out of ideas," said House Speaker Doug Mays (R-Topeka).

Sebelius denounced the legislature for not passing a tax hike, issuing a statement saying legislators "couldn't summon the courage to meet the challenge." She raised the specter of a special session later this year.

"I believe there is at least a 90 percent chance of a 2004 special session being called by Sebelius," said Peterjohn. "That is why I referred to winning a battle and not the 2004 fiscal war. There may even be some election fall-out [from taxpayers]."

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

NTU Chided for Kansas Effort

Involvement in Kansas's tax hike debate by the Washington, DC-based National Taxpayers Union (NTU) touched a raw nerve among some observers of the state's political scene.

In an April 26 column for the *Kansas City Star* titled "Outsiders, Leave 'Our' State Alone," Mike Hendricks complained about NTU's participation in the debate, asking "Don't you love it when the Washington know-it-alls presume to know what's best for us yokels in the backcountry?"

John Berthoud, President
National Taxpayers Union

NTU defended its effort. "We have more than 5,000 living, breathing reasons to oppose higher taxes in Topeka," said NTU President John Berthoud. "They're called our members and supporters, who joined NTU precisely for this kind of effective advocacy on their behalf at all levels of government."

"The education establishment's minions in the media were too upset with NTU's message to bother with a reasonable debate over the issue," asserted Pete Sepp, the group's vice president for communications. "Instead, they leveled the desperate charge of carpetbagger.

"Such an accusation might better have been leveled at the teacher unions, who mounted a slick pressure campaign on behalf of tax hikes," said Sepp.

Berthoud observed that NTU routinely opposes tax hikes and supports tax limits for its members across the country. Recent NTU efforts have taken place in Alaska, California, Iowa, Minnesota, New Jersey, Ohio, Oregon, Virginia, and Wisconsin.

"Instead of asking taxpayers to bear higher burdens for bigger government, policymakers should consider innovative solutions to bring the budget back under control," Berthoud said. "Giving parents the freedom to direct education dollars to schools of their choice, along with a constitutional measure to limit spending growth and require voter approval for higher taxes, would be a winning combination for Kansas."

— J.S.

Budget & Tax News

is free for elected officials.

Others may subscribe for $36 for 10 issues!

Sign up online at www.heartland.org, call 312/377-4000, or write to:

The Heartland Institute
19 South LaSalle Street #903
Chicago, IL 60603

The Heartland INSTITUTE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Special Session of Texas Legislature Achieves Nothing

by Byron Schlomach

A special session of the Texas legislature, called by Governor Rick Perry (R) to address school finance issues, closed on May 17 without accomplishing a thing.

The governor and state legislators had agreed on the special session's goals: to "eliminate the state's Robin Hood school finance system," where local property taxes are shared among school districts in order to equalize funding, and to enact property tax relief. Little agreement was reached, however, on how to achieve those goals.

No Lack of Effort

The failure of the legislature to devise a new school funding system was not for lack of effort, which began more than a year ago during the 140-day biennial regular session of the Texas legislature. A school funding lawsuit loomed at the time, and a large freshman class in the House had promised to address the issue. Policymakers passed a stop-gap bill that pledged a new funding system would be developed by September 2004.

To make good on that pledge, 37 of the House's 150 members sat on a Select Committee to review school funding matters, hearing hours of testimony on school finance formulas, local property taxes, and state taxes. There was also a Joint Select committee, consisting of House and Senate members plus a handful of blue-ribbon appointees, including education researcher and economist Caroline Hoxby of Harvard University. No consensus emerged from either group.

Perry, who had made consensus a prerequisite, called the special session in the hope it would produce what the select committees could not. "I believe we can reform our school finance system without a major tax hike, without a broad-based business tax, and without an across-the-board rate hike on the existing sales tax base," said Perry at the special session's start. He made clear his opposition to anything that smacked of an income tax. "I will further protect Texans by opposing a personal income tax in any shape or form," he pledged.

Tax Alternatives Considered

Prior to and during the special session, many tax alternatives were considered. State Representative Kent Grusendorf (R-Arlington), chair of the House Select Committee on Public School Finance and co-chair of the Joint Select Committee on Public School Finance, floated the idea of a business activity tax on payrolls and profits. Whether to implement such a tax "is the $64,000 question," Grusendorf said, "Or maybe I should say the $64 billion question." Perry and others, however, strongly opposed the idea.

The governor's revenue proposals also seemed to invite more opposition than support. He proposed allowing video lottery terminals at race tracks and on Indian reservations and a series of "sin" taxes such as entry fees to strip clubs, which together he said would fund up to $1 billion in new education spending.

A Bill Emerges

The House Select Committee ultimately developed a 300-page bill that included a payroll tax, video lottery terminals, an increase in the sales tax rate, and a substantial cigarette tax increase. The package provided for property tax relief, ended the Robin Hood school funding scheme, and provided more money for public education. During debate over the bill, the payroll tax and video lottery provisions were stripped, so great was opposition to them. The state's franchise tax, which was to be repealed, was reinstated and the sales tax broadened to make up for the lost revenue.

Texas Gov. Rick Perry (center) meets in his office with state senators at the opening of the legislature's special session. Though the senators pledged they were ready to "go to work" on school finance and property tax relief, the session ended May 17 without reform.

After only a day of discussion, debate in the House was abruptly cut short and the bill was called for a vote. On the first vote, it was defeated. Several hours later, the vote was taken again, and the measure passed to the Senate.

The Senate took up the measure as a committee of the whole. After a week, it became clear the body would not take action on the bill. Lieutenant Governor David Dewhurst (R), who presides in the Senate, explained, "I cannot understate how difficult this is going to be. The House has sent us a bill that isn't balanced."

When the Senate debated the bill, the results were anti-climactic. Even a class of fourth-graders visiting the capitol, who thought they would get a government and school finance lesson, were disappointed. Their teacher described the scene. "We didn't see anything in the chamber. They just, they started and then they stopped."

Standstill and Clarification

In a nutshell, that describes the fourth special session of the 78th Texas Legislature. Perry put the best possible spin on the session saying, "Taxpayers should know that this session was productive because it clarified the challenge and focused the debate on the finer details of education reform and public school finance."

Byron Schlomach is chief economist for the Texas Public Policy Foundation. His email address is **bschlomach@texaspolicy.com**.

Oregon

Continued from page 1

ed with higher taxes. State Sen. Jackie Winters and Rep. Vic Backlund (R-Keizer) were punished for supporting a budget-balancing tax increase in 2003 that was trounced by voters when placed on the Feb. 3 ballot as Measure 30."

Measure 30 was an up-or-down vote by the citizens of Oregon on the legislated tax hike. Oregonians firmly rejected the higher taxes. (See "Oregon Voters Soundly Reject Tax Hike," *Budget & Tax News*, March 2004.) Winters was one of few Republican legislators who voted with Democrat Governor Ted Kulongoski to raise taxes in 2003.

"Tax and spend politicians in Oregon, regardless of political affiliation, are slowly learning their lessons," said Rob Jordan, a spokesperson for Citizens for a Sound Economy (CSE). "When the results of the Oregon primary election came in, the impact of these efforts was readily apparent. Every candidate that supported CSE and our issue agenda won."

According to the *Statesman Journal*, Zupancic, a former Lake Oswego School Board member, "hammered Winters" for supporting the tax package voters rejected in Measure 30.

"I think we had a very clear message," a jubilant Zupancic said after his victory. "I think Measure 30 helped frame a very critical issue, and that was the size of government and taxes."

"Jim Zupancic ran some real negative ads on Jackie, calling her a liberal—the dreaded L word—and that's had an effect," said David Buchanan, a Salem resident and coauthor of the *Almanac of Oregon Politics*.

Not Only in Oregon

Winters' loss comes on the heels of a Republican primary in Nebraska's first congressional district, where the speaker of the state legislature, Curt Bromm, refused to pledge against tax hikes and lost. Bromm, who had received the endorsement of outgoing Rep. Doug Bereuter (R), was heavily favored to win.

"Republicans who vote to raise taxes have pointed a 12 gauge shotgun at the heads of their careers and pulled the trigger," said taxpayer advocate Grover Norquist, who heads Americans for Tax Reform (ATR) in Washington, DC. "Republicans even thinking about raising taxes should look at how Sen. Jackie Winters and Speaker Bromm in Nebraska have destroyed their political futures."

> **"I think we had a very clear message. I think Measure 30 helped frame a very critical issue, and that was the size of government and taxes."**
>
> JIM ZUPANCIC

Many states faced what policymakers referred to as "budget shortfalls" in 2001-2003, pressuring legislative bodies to raise taxes. The political fallout of doing so, especially for Republicans, is palpable.

Republican governors who presided over tax increases—most notably Nevada's Kenny Guinn and Alabama's Bob Riley—are not expected to run for higher office. But those who addressed their budget shortfalls without tax increases are widely speculated to be in the running for President in 2008. Govs. Bill Owens (Colorado), Jeb Bush (Florida), Mitt Romney (Massachusetts), Rick Perry (Texas), Tim Pawlenty (Minnesota), and Craig Benson (New Hampshire) are all thought to have ambitions for higher office.

"The fastest way to end a Republican's career is to vote for a tax hike," said Norquist. "And redemption in this business doesn't come easy."

Russ Walker of Oregon CSE commented, "The trend is encouraging, but there is much work to be done. Tax and spend politicians need to get the message we don't need you in Salem."

The Oregon primary sets up a Fall race between Zupancic and four-term congressional incumbent Darlene Hooley (D-West Linn). "I think it'll be an interesting race and contrast," Hooley said from her Washington, DC apartment. "I think it'll be a bigger contrast with Mr. Zupancic" than with Winters.

Jonathan Collegio is communications director for Americans for Tax Reform. His email address is **jcollegio@atr.org**.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Moody Upgrades California's Credit Rating

by John Skorburg

California Governor Arnold Schwarzenegger (R) is on a roll. Not only has he won praise from taxpayer advocates by achieving a no-new-taxes budget, but his actions have been rewarded by the financial community as well: Moody's Investment Services has upgraded the state's credit worthiness.

Reported the *Sacramento Chronicle* on May 22, "California's shoddy credit rating received its first boost in four years [on May 21], as Moody's upgraded the state's credit rating one notch a week after Gov. Arnold Schwarzenegger released his revised budget." Moody's is one of the nation's major credit rating agencies.

Schwarzenegger did not hesitate to express his appreciation for the upgrade—and to remind state policymakers the next move is theirs. "Today's upgrade by Moody's is fantastic news," he said in a statement to the press. "Their financial analysts have had a chance to carefully review our revised budget and our economic outlook, and they've concluded that it warrants an improvement in California's standing in the nation's financial markets. I appreciate their strong vote of confidence in the new direction that we're taking California.

"However," continued Schwarzenegger, "they are staking this vote of confidence on our ability to approve this budget. We should now return the favor by doing the right thing, and that is for the Legislature to get this balanced and responsible budget passed on time. ... I ask the Legislature to work with me and with each other to make this happen—and to show the people that we're continuing to work together to keep California moving forward."

The governor released his revised state budget on May 13. The $102.8 billion two-year plan calls for fewer across-the-board spending cuts than his original proposal, and relies more on borrowing, one-time savings, and money from the federal government. The new plan, coupled with an improving economy, is expected to bring in more tax revenues and cut the state's budget deficit, without a general tax increase.

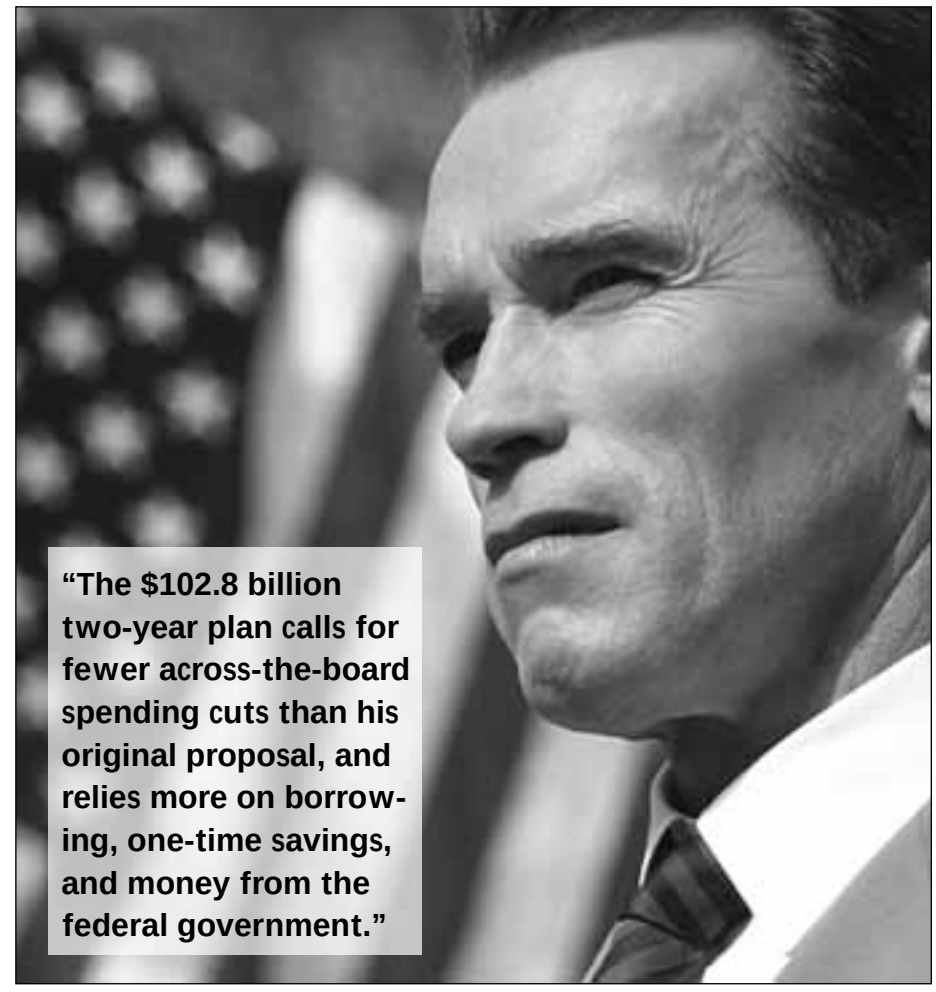
"I am determined to protect essential services, not only for this generation of Californians but the next generation as well," Schwarzenegger said when announcing his revised plan.

Schwarzenegger hopes to see the revised budget implemented by July 1, the first day of the new fiscal year. "The people are tired of the summer slamfest in the Capitol," he said. "I am proud, and I'm all pumped up, and I'm ready."

Schwarzenegger said it will take "more than one year to right the state's fiscal ship," acknowledging in an interview with *Sacramento Bee* columnist Dan Weintraub that "gimmicks" are an integral part of his current budget proposal.

"Of course I couldn't cut $15 billion. It's too much," Schwarzenegger said. "So what we had to do is cut half of that, then support it with gimmicks that the previous administration used because I could not perform a miracle and say, 'Let's just produce $15 billion out of the air without raising taxes.'" The governor has held firm in his no new taxes pledge.

Moody's upgrade of California's credit rating from Baa1 to A3 reflects the "state's improving economy and the governor's move toward a budget that may pass muster with the Legislature," said Renee Boicourt, director of the Public Finance Group at Moody's. "While the budget isn't done, we see the May proposal as more politically viable than the earlier (January) proposal," she said.


"The $102.8 billion two-year plan calls for fewer across-the-board spending cuts than his original proposal, and relies more on borrowing, one-time savings, and money from the federal government."

Moody's said voter approval in March of $15 billion in deficit bonds "significantly improved the state's fiscal outlook." Passage of the bonds allowed the state to pay off short-term borrowing due in June.

Moody's also noted, however, that the prospect of "continuing deficits remained the state's primary concern.

"The budget's structural imbalance situation represents a significant ongoing fiscal challenge for California and is a primary reason for the still quite low bond rating relative to other states," the Moody's report concluded.

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

Massachusetts Should Cut Income Tax to 5 Percent

by Frank Conte

A June 10 economic analysis by the Beacon Hill Institute (BHI) at Suffolk University finds the Commonwealth could create thousands of new jobs and millions of dollars in new investment if, as Governor Mitt Romney (R) proposes, the legislature would cut the income tax from 5.3 percent to 5 percent. The state could increase spending in FY 2005 by 7.57 percent over FY 2004 even as it absorbed the loss in tax revenue that the tax cut would bring about.

Massachusetts Governor Mitt Romney (R)

BHI bases its findings on its State Tax Analysis Modeling Program (STAMP). In December 2003, BHI predicted FY 2004 tax revenues would be $15.532 billion, relying in part on STAMP to make its forecast. A report from the state shows the actual amount will be $15.746 billion, meaning BHI's December forecast will be within 1.4 percent of the actual amount and more accurate than any other recognized forecast made at that time.

Using STAMP, BHI finds that, by cutting the income tax to 5 percent effective January 1, 2005, the state would experience an immediate rise in employment of 3,683 jobs and a rise in investment of $7.3 million. Real (inflation-adjusted) disposable income would rise by $243 million. By 2008, the state would have 7,885 new jobs, $17.1 million in additional investment, and $469 million in additional disposable income.

The proposed tax cut would cause FY 2005 tax revenues to be $237.1 million less than they would have been without the tax cut. In subsequent years, the annual shortfall would be about $500 million. However, that loss in tax revenue would be offset by a surge in tax revenues brought about by an improving economy. FY 2004 tax revenues will exceed FY 2003 tax revenues by about $775 million, or 5 percent. And even with the tax cut, FY 2005 tax revenues would exceed FY 2004 revenues by $307 million, or 2 percent.

This would make it possible for taxpayers to enjoy the benefits of the tax cut while allowing the state to increase spending. Using its updated revenue forecast, BHI finds the state could increase spending in FY 2005 by 7.57 percent even as it cut the income tax rate to 5 percent, as proposed by the governor.

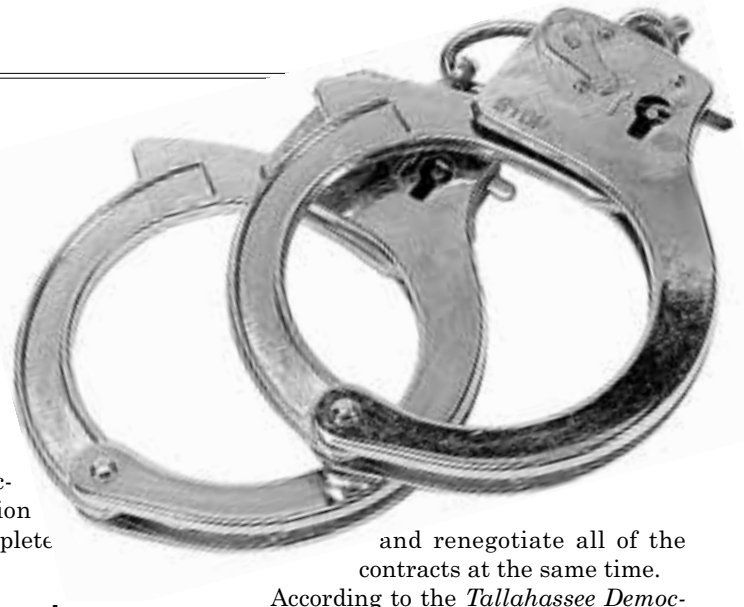
In 2000, Massachusetts voters approved, by a large margin, a ballot measure cutting the income tax rate to 5 percent over a period of three years. In 2002, the state temporarily froze the rate at 5.3 percent owing to a sharp fall in tax revenues.

In commenting on BHI's findings, David G. Tuerck, executive director of the Institute, said, "the state is now in a position to honor the will of the voters, as expressed four years ago." Said Tuerck, "By cutting the tax rate, the state can simultaneously strengthen the state economy and grow state government at a respectable pace."

Frank Conte is director of communications for the Beacon Hill Institute. His email address is **fconte@beaconhill.org.**

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

States Tap Private Prisons



by Geoffrey F. Segal

Prison privatization remains an attractive option for governors and state legislators seeking to control spending and balance budgets. In addition to recently announced agreements between Corrections Corporation of America (CCA) and the states of Minnesota and North Dakota (see "Privatization of Prisons Continues in Minnesota and North Dakota"), state legislatures from California to Virginia have taken up prison outsourcing measures.

Lawmakers in Virginia recently passed House Bill 1042, which requires the state's department of corrections to conduct a "cost-benefit analysis or public-private competition" for any new prison to be built in the state.

Virginia Delegate Chris Saxman (R-Staunton), who authored HB 1042, said on its passage, "The benefits of competition are well known: better quality at a lower cost. Even when you factor in the need to maintain public safety, you can still find opportunities for increasing performance and lowering costs."

Virginia currently has one private prison and has contracted for some of the medical operations in others.

In California, Governor Arnold Schwarzenegger (R) has put private prisons back on the table, after former Governor Gray Davis (D) abruptly ended three contracts with private community correctional centers in 2003. "It is a priority of my administration to reform the California prison system," said Schwarzenegger, who said his investigation into reform options will include the use of privatization.

"The benefits of competition are well known: better quality at a lower cost. Even when you factor in the need to maintain public safety, you can still find opportunities for increasing performance and lowering costs."

HON. CHRIS SAXMAN
VIRGINIA DELEGATE

Colorado, long a believer in private prisons, has increased its use of privatization by agreeing to send a population of up to 128 Colorado maximum-security inmates to CCA's Tallahatchie County Correctional Facility, located in Tutwiler, Mississippi. The one-year contract is effective through June 30, 2005, with four one-year options for extension.

The most complicated extension of prison privatization is occurring in the state of Florida where a commission is being phased out and a department is taking over responsibilities.

The Florida Correctional Privatization Commission will complete its official duties on July 1. In one of its final actions, the commission has renewed for another year contracts for three of the state's five private prisons.

After July 1, corrections contracts in Florida will be monitored and administered through the Department of Management Services (DMS). The one-year private prison extension now places all of the prison contracts on the same time frame and will allow DMS to reevaluate and renegotiate all of the contracts at the same time.

According to the *Tallahassee Democrat*, CCA has the contracts for operating Florida's Gadsden, Bay, and Lake City facilities, while GEO Group operates the Moore Haven and South Bay facilities.

South Carolina lawmakers are considering privatizing medical operations within the state's correctional system. According to a January 2004 Associated Press report, the South Carolina Corrections Department pays almost twice the national average health care cost for sick inmates. Corrections Director Jon Ozmint said, "The prisons system spends $56 million annually on inmate health care, 19 percent of its budget." The national average is 10 percent.

Geoffrey F. Segal is director of privatization and government reform at Reason Foundation. His email address is **geoffrey.segal@reason.org**.

Privatization of Prisons Continues in Minnesota and North Dakota

by Louise Chickering

Corrections Corporation of America (CCA), the nation's largest provider of corrections management services to government agencies, announced on May 20 that it has entered into new agreements with the states of Minnesota and North Dakota to house some of those states' inmates at the company's Prairie Correctional Facility in Appleton, Minnesota. CCA previously had contractual relationships with both states.

"We are very appreciative of the confidence both Minnesota and North Dakota have placed in CCA by entrusting populations of their inmates to our care," said John Ferguson, CCA president and CEO. "CCA is committed to providing excellent-quality operational service to these state customers. We hope to develop long-standing relationships to meet these states' fluctuating correctional needs."

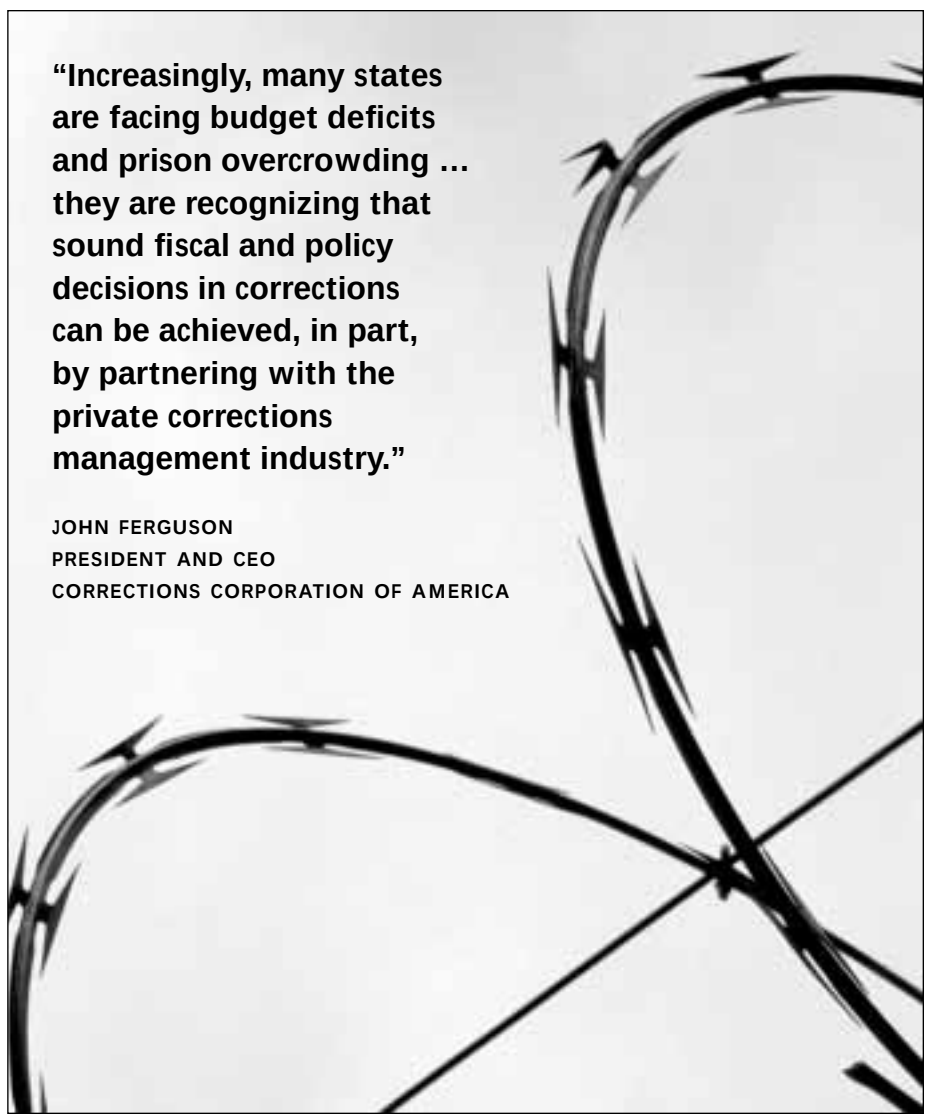
Ferguson added, "Increasingly, many states are facing budget deficits and prison overcrowding. With limited resources, they are recognizing that sound fiscal and policy decisions in corrections can be achieved, in part, by partnering with the private corrections management industry. It is our privilege to contribute to these state correctional systems by providing safe and secure corrections management, along with quality programming for inmates."

Under the agreement between CCA and the Minnesota Department of Corrections, CCA will manage an unspecified number of medium-security male inmates at the Prairie facility. The company expected to receive an initial population of roughly 100 Minnesota inmates by the end of June. The population may fluctuate based on the state's needs and the space available at the Prairie facility. The terms of the contract include an initial one-year period through June 30, 2005, with two one-year renewal options.

The North Dakota agreement, which became effective in March 2004, has an initial term through February 2005 with an indefinite number of annual renewal options. That contract, similar to the Minnesota agreement, does not specify how many inmates will be managed by CCA. The company presently houses approximately 40 North Dakota inmates and expects that number to near 50 early this summer. The numbers are also expected to vary based on the state's needs and space availability.

In addition to the North Dakota inmates, the 1,338-bed medium security Prairie Correctional Facility also houses approximately 1,100 inmates from the state of Wisconsin. CCA expects that number to fall as the state's own correctional facilities have increased capacity and will be taking back inmates this year.

Louise Chickering is vice president for marketing and communications with Corrections Corporation of America. Her email address is **marketing@correctionscorp.com**.


"Increasingly, many states are facing budget deficits and prison overcrowding … they are recognizing that sound fiscal and policy decisions in corrections can be achieved, in part, by partnering with the private corrections management industry."
JOHN FERGUSON
PRESIDENT AND CEO
CORRECTIONS CORPORATION OF AMERICA

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

*This is the National Debt.**

$7,217,554,314,339.98

This is your share – $24,510.40.

Isn't it time you joined a think tank?

The Heartland Institute is a national nonprofit organization devoted to informing elected officials and the public on important public policy issues. It publishes *Budget & Tax News*, as well as monthly newspapers on taxes, health care, and school reform and other publications addressing a wide range of topics.

We invite you to join the more than 1,600 individuals, foundations, and corporations who want to make the world a better place. Have the satisfaction of knowing you are working with others to restore the individual freedom and limited government that made this country great.

$29 Members receive:
- Membership certificate
- *The Heartlander*, a monthly newsletter
- Free policy studies
- Invitations to events

$49 Members will also receive:
- 20 percent off admission to all events
- Any two of our four monthly newspapers (a $72 value!)

$99 Members will also receive:
- All four monthly newspapers (a $144 value!)
- Free Heartland books and major publications
- Recognition in *The Heartlander* and the Anniversary Benefit program

* Source: Bureau of the Public Debt, U.S. Department of the Treasury

The Heartland INSTITUTE
www.heartland.org

Yes! I want to become a Heartland Institute member.

Membership
- ❑ $29 Basic
- ❑ $49 Sustaining
- ❑ $99 Premium

Additional Contribution
- ❑ $1,000
- ❑ $500
- ❑ $250
- ❑ $100
- ❑ $50
- ❑ $25
- ❑ Other _____

- ❑ *Please send me additional information about The Heartland Institute.*
- ❑ *Please send me information about advertising in Heartland publications.*

❑ My check in the amount of $_____ is enclosed. ❑ Charge $ _____ to my ❑ Visa ❑ MC ❑ Am Ex

ACCOUNT NUMBER

EXPIRATION DATE

SIGNATURE

NAME HOME PHONE

TITLE•COMPANY WORK PHONE

ADDRESS

CITY•STATE•ZIP

The Heartland Institute is an independent nonprofit organization founded in 1984. Contributions are tax deductible under Section 501(c)3 of the Internal Revenue Code.

Please return this form to:
The Heartland Institute
19 South LaSalle St. #903
Chicago, Illinois 60603
fax 312•377•5000

The Heartland INSTITUTE

BTN7/04

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Study Ranks States by Economic F

Kansas, Colorado, and Virginia rank best on PRI Economic Freedom Index

by John Skorburg

A new report issued by the Pacific Research Institute for Public Policy (PRI) ranks Connecticut, California, and New York lowest in terms of "economic freedom"—how friendly or unfriendly state governments are toward free enterprise. Kansas, Colorado, and Virginia rank highest in the report, which was featured in *Forbes* magazine's May 2004 "Best Places" issue.

"Where should you locate new businesses and subsidiaries?" asked Lawrence J. McQuillan, director of business and economic studies at PRI, in an article for *Forbes*. "In states with the fewest regulatory body blocks and fiscal obstacles."

PRI, an independent nonprofit research organization based in San Francisco, teamed up with economists Ying Huang and Robert E. McCormick of Clemson University to create the "U.S. Economic Freedom Index."

"In coming up with our ratings we evaluated 143 variables for each state, using the most recent data," explained McQuillan. "This snapshot includes tax rates, state spending, occupational licensing, environmental regulations, income redistribution, right-to-work and prevailing-wage laws, tort laws, and the number of government agencies. These we grouped into five sectors—fiscal, regulatory, judicial, size of government, and social welfare.

"For each of the 143 variables we ranked states from 1 (most free) to 50 (least free), calculated an average sector ranking, and then weighted them to get an overall score," continued McQuillan. "Welfare, fiscal, and regulatory matters counted about equally; government size and judicial ratings counted for less."

California at "Bottom of the Barrel"

"California ranks at or near the bottom in almost every measure of economic freedom: 48 in welfare spending/income redistribution, 48 in fiscal responsibility, and last, 50th, in regulatory burdens," said McQuillan. "As a result, California is at the bottom of the barrel in economic freedom," he said.

"Governor Schwarzenegger must focus his energies, as he has, on rebuilding the state's business climate through low taxes, less regulation, and commonsense reform of the rules and organization of California's government," continued McQuillan. "There is no better model to follow than Colorado—ranked #2 in economic freedom—which has a constitutional limit on tax increases."

Only New York ranks worse than California. The Empire State fares especially poorly on government size and welfare spending/income redistribution, where it ranks 50th. It ranks 47th on fiscal, 42nd on regulatory, and 45th on judicial matters. "New York is consistently bad," summarized McQuillan.

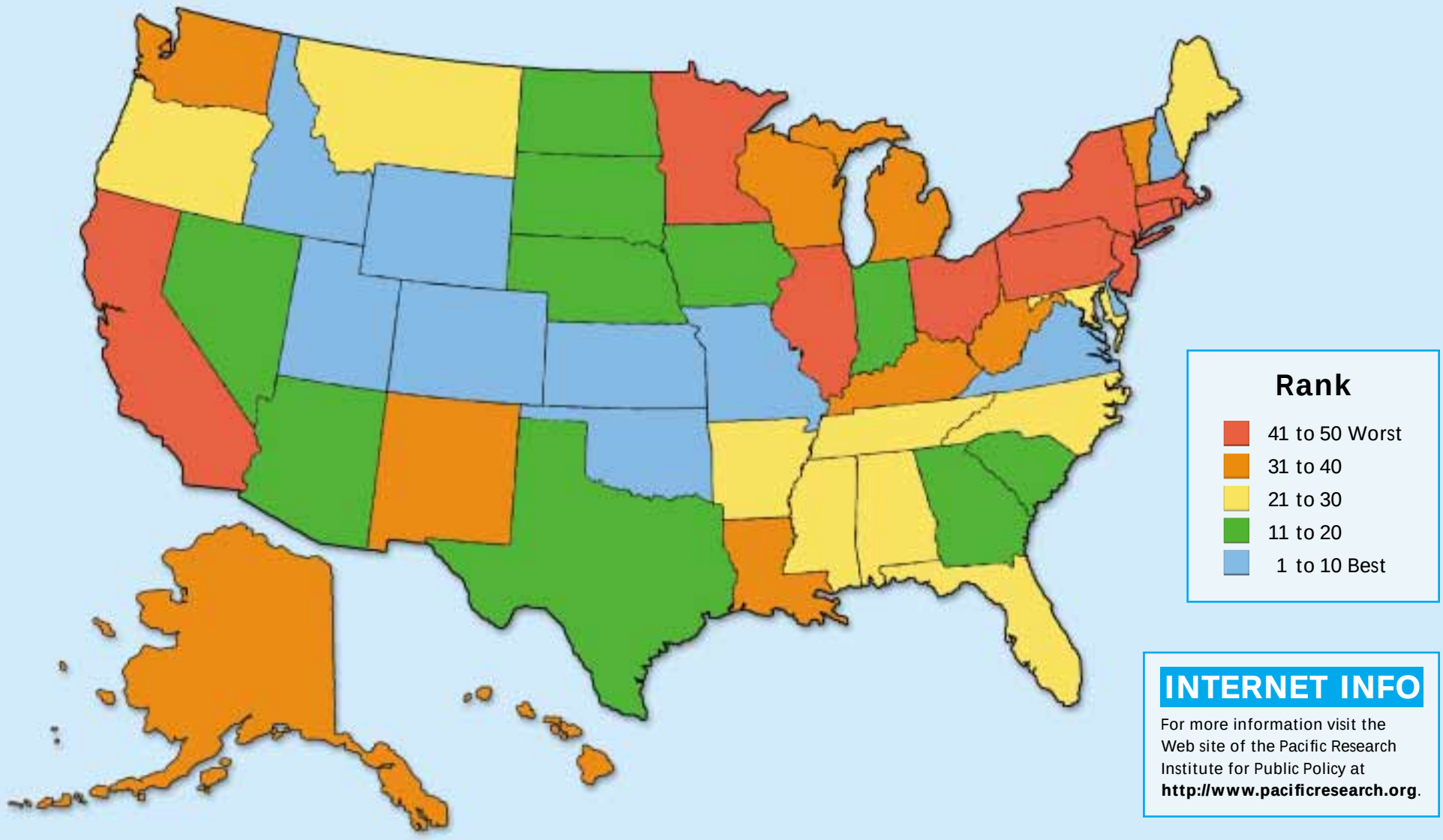
Kansas, by contrast, ranks best on the PRI index due largely to its "respect for property rights." Kansas also "engages in less income redistribution and attracts less tort litigation than most states." The Kansas legislature is now considering innovative bills exempting custom software from sales taxes and eliminating the state franchise tax for most businesses—a "serenade to entrepreneurial ears," noted McQuillan.

Kansas risks losing its top ranking, however, once the dust settles on the state's current battle over taxes and education finance.

Colorado, "with the fewest regulatory barriers," according to McQuillan, ranks second overall. The state also ranks high in the fiscal sector of the economic index, thanks to its constitutional tax and expenditure limitation—the TABOR (Taxpayers' Bill of Rights) adopted in 1992. Virginia, which shows "restraint in income redistribution" is currently third, but may fall in future indices depending on the impact of its recent tax hike. (See "Virginia Passes $1.6 Billion Tax Hike; Voters May Not Forget," *Budget & Tax News*, June 2004.)

In general, the South "does not live up to its image as a business-friendly region," said McQuillan. The states most hospitable to free enterprise tend to be in the Great Plains and Rockies. The most "punitive policy environments" are in California, Connecticut, New York, and Rhode Island. (See accompanying map.)

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.



INTERNET INFO

For more information visit the Web site of the Pacific Research Institute for Public Policy at **http://www.pacificresearch.org**.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

c Freedom

1=Best, 50=Worst	
State	**Rank**
Alabama	25
Alaska	33
Arizona	11
Arkansas	23
California	49
Colorado	2
Connecticut	48
Delaware	8
Florida	22
Georgia	19
Hawaii	35
Idaho	4
Illinois	46
Indiana	14
Iowa	16
Kansas	1
Kentucky	39
Louisiana	40
Maine	30
Maryland	27
Massachusetts	41
Michigan	34
Minnesota	44
Mississippi	28
Missouri	10
Montana	21
Nebraska	20
Nevada	12
New Hampshire	7
New Jersey	42
New Mexico	37
New York	50
North Carolina	24
North Dakota	18
Ohio	43
Oklahoma	6
Oregon	29
Pennsylvania	45
Rhode Island	47
South Carolina	13
South Dakota	15
Tennessee	26
Texas	17
Utah	5
Vermont	36
Virginia	3
Washington	31
West Virginia	32
Wisconsin	38
Wyoming	9

BUDGET WATCH

State Budget Gaps Shrink

States report budget improvements

Closing the Gap, 2004-2005

Number of states with ...	Fiscal Year 2004	Fiscal Year 2005
Gaps at the start of budget negotiations	42	33
Gaps above 5 percent	37	16
Gaps above 10 percent	19	8
Highest budget gap estimate	$78.4 billion	$36.3 billion

by Gene Rose

More than half the states are projecting surpluses by the close of the current fiscal year, a sharp contrast to the situation they faced a year ago, according to a new report by the National Conference of State Legislatures (NCSL).

At this time in 2003, states were still struggling to close a cumulative $21.5 billion budget gap. Now they are working to close a total gap of $720 million, according to NCSL's *State Budget Update: April 2004*. Thirty-two states are forecasting surpluses by the end of FY 2004, which ended June 30 for most states. Those projected surpluses are the result of improved collections in major revenue categories and paring of programs.

Nine states expect surpluses below 1 percent of their general fund budgets. In five states—Florida, Nevada, Oklahoma, South Dakota, and Wyoming—the surpluses are larger than 5 percent. But this breathing room comes after three consecutive years of fiscal crisis, when states cut funding in such areas as education, health care, and corrections. Some states tapped rainy day funds, increased fees, or raised taxes on items including cigarettes, health insurance, and phone service to help make ends meet.

"States are turning red ink black," said NCSL Executive Director Bill Pound. "They should be praised for their diligence and their willingness to make tough and often unpopular decisions that were necessary to get through the fiscal crisis. States are also grateful for help from the federal government this past year."

Federal aid in 2004 provided $10 billion in Medicaid relief and $10 billion in discretionary funds.

At least two-thirds of states report higher-than-expected revenue performance in at least one major tax category. Personal income taxes were above estimates in 18 states, and on target in 12. Twenty-two states report sales tax collections are higher than forecasted. And corporate income tax collections are exceeding expectations in more than half of states. They're on target in 11 others.

FY 2005 Outlook

Budgets don't look healthy in FY 2005 just yet, although they are an improvement over the fiscal situation states faced going into FY 2004. Thirty-three states are resolving budget gaps as they negotiate their FY 2005 budgets. The aggregate gap reached $36.3 billion, half as high as the gap states faced going into FY 2004.

Some states are expecting a positive picture. At least 12 project surpluses, bringing the cumulative surplus to about $1.9 billion. These surpluses continue to be modest, though, with Hawaii, Ohio, Oregon, and Texas reporting surpluses of less than 1 percent of their budgets.

"The national economy seems to be improving," Pound said. "But all states have not felt the full strength of the recovery."

Gene Rose is public affairs director for the National Conference of State Legislatures. His email address is **gene.rose@ncsl.org.**

INTERNET INFO

NCSL's *State Budget Update: April 2004* is free to members of the media; for a copy, contact the public affairs staff at **press-room@ncsl.org**. Others may purchase a copy of the report for $30 by contacting NCSL's publications department at 303/364-7700 or sending an email to **books@ncsl.org**.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Zero Tax

Continued from page 1

noted Moody. "When these non-filers are added to the zero-tax filers, they add up to 58 million income-earning households who will be paying no income taxes," he said.

Even 58 million is an undercount, Moody noted, because one tax return often represents several people. When all of the dependents of these income-producing households are counted, roughly 122 million Americans—44 percent of the U.S. population—are entirely outside of the federal income tax system.

Portrait of Zero-Tax Filers

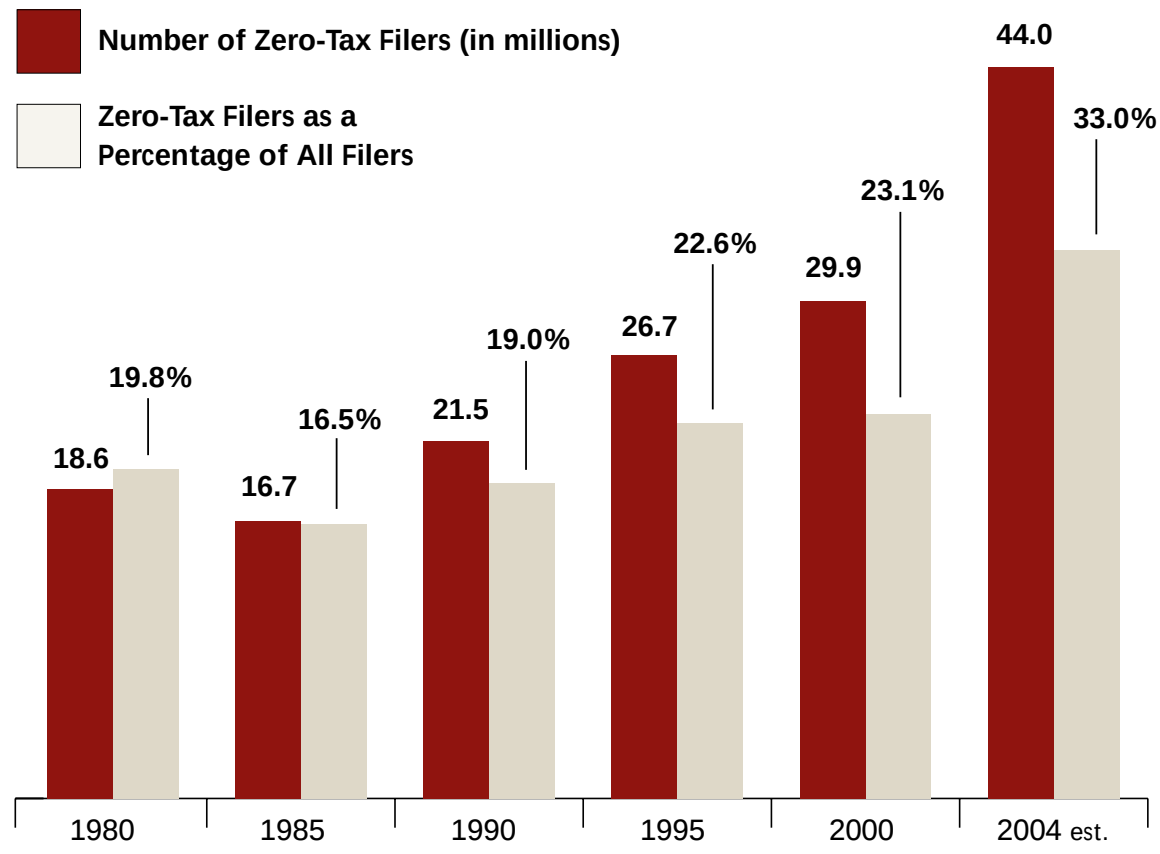
Considering how fast the population of zero-tax filers is growing, it is important for lawmakers to have a better understanding of who they are. Tax Foundation economists employ a sophisticated database, combining IRS tax return data with Census household data, to gain insights into the economic and demographic profiles of these Americans.

"Broadly speaking, the 44 million zero-tax filers are low-income, young, female-headed households, part-time workers, and beneficiaries of the $1,000 per-child tax credit" said Moody.

- The 44 million zero-tax filers will be largely low-income. Seventy-five percent will earn less than $20,000 in 2004, and 97 percent will earn less than $40,000.
- Zero-tax filers in 2004 will be overwhelmingly young. Looking at the age of the primary breadwinner on these tax returns, only 22 percent are 45 years old or older. More than one-third (36 percent) are younger than age 25, and 56 percent are younger than age 35.
- The racial or ethnic composition of the 44 million zero-tax filers will roughly mirror the demographics of American tax filers as a whole. For example, white Americans are 83 percent of total taxpayers; the percentage of zero-tax filers who are white is 79 percent. African-Americans are roughly 13 percent of total taxpayers and 17 percent of zero-tax filers.
- Some 54 percent of 2004's zero-tax filers will be single women or families with children where the principal wage earner is a woman. That will leave 46 percent of zero-tax filers in 2004 who will be men or families in which a man is the major breadwinner.
- The overwhelming majority of tax returns that will pay no income taxes will be filed by single individuals or heads of household (an unmarried individual with children). Due in large part to their young age, 43.5 percent of these filers are single, while 27.6 percent are single parents.
- Zero-tax filers tend to be working part-time or full-time for only part of the work year. Forty-two percent will be working part-time or hardly at all, while another 20 percent will be working full-time but less than 50 weeks out of the year.
- The occupations of zero-tax filers are difficult to generalize because of the large number of categories government statistics tend to group them in. However, due again to their young age, 20.2 percent of these filers are classified as "children" or "students" rather than by their occupations. The other leading categories of occupations are "other services" (17.2 percent), "administrative support" (11.8 percent), "sales" (11.4 percent), and "precision production" (7.6 percent).
- In 1997, Congress enacted a $500 per-child tax credit and expanded the Earned Income Tax Credit (EITC) for low-income workers. The 2003 tax cuts increased the value of the child credit to $1,000. These two tax credits, especially the child credit, have had a powerful effect on reducing, and in many cases eliminating, the income tax liability for millions of Americans. Of the 44 million tax returns that will pay no income taxes, 34 percent will claim the EITC and 50 percent will claim the child credit.

Scott Hodge is president of the Tax Foundation. His email address is **shodge@taxfoundation.org**.

Number of Zero-Tax Filers Is Growing



Source: IRS Statistics of Income and Tax Foundation estimate.

China Doll

Chicago's Finest Accommodation for Business Travelers

The China Doll is designed to be a completely equipped office away from home for the serious business traveler. China Doll is priced well below the typical downtown hotel, and it's an inexpensive 15-minute cab ride away from most business destinations.

When booking your reservation, mention The Heartland Institute and get a special rate. Call today!

773.525.4967 • 773.525.3929 fax • 866.361.1819 toll free • www.ChinaDollChicago.com

JimYanan@Yahoo.com

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Sin Taxes: Inferior Revenue Sources

by Robert A. Sirico

The search for government revenue in fiscally tight times tempts legislators to raise revenue by imposing unusually high excise taxes on cigarettes, liquor, gambling, and so on. This type of charge, often called a "sin tax," appeals to voters who view it as a way of discouraging consumption of certain objectionable products. Yet the temptation to impose sin taxes is one that should be resisted for economic reasons.

The consequences of the sin tax are often the very opposite of those intended by its designers. Rather than increasing revenue, the sin tax can reduce it. Rather than discouraging what are regarded as morally questionable behaviors, the sin tax can make them more appealing. Rather than reducing what are perceived to be internal costs of the sin, the sin tax can increase them and expand them to society as a whole.

"The consequences of the sin tax are often the very opposite of those intended by its designers. Rather than increasing revenue, the sin tax can reduce it. Rather than discouraging what are regarded as morally questionable behaviors, the sin tax can make them more appealing."

Long-Standing Tradition

The use of sin taxes and controls on vice generally date back to before the Founding. Puritan New England was awash in laws attempting to control sin, and the means varied from taxes to outright prohibition. These were known as sumptuary laws, defined as the regulation of extravagance in food, dress, tobacco use, and drinking on religious and other grounds.

Our present era, though hardly akin to Puritan times in its faith in God, is no less anxious to pass laws to enforce minute aspects of behavior. Rather than let these laws go unenforced, as the Puritans eventually did, today we seem to have become even more confident about the ability of the right legislation to overcome intractable desires on the part of the consuming public.

Canada's experience with cigarette taxes provides a poignant case. Throughout the 1980s and early 1990s, Canadian and American smugglers met at the border, many driving in snowmobiles so as to avoid customs agents. Violence and gunplay increased. Apparently most of the cigarettes being brought into Canada in underground markets were actually manufactured in Canada, exported to the United States, and brought back into the country by disreputable elements. The same wholesalers have been known to buy back the cigarettes and sell them again.

In the official market, a case of cigarettes, which is 50 cartons, sold at an official price of $2,500. But in the informal market, smugglers pay only $700. They then sell it back in the underground at a price of $1,500. As much as 80 percent of Canada's export market ends up back in Canada. That means an enormous amount of fast profits high enough to lead people to take exorbitant risks. In three months, from November 1993 to January 1994, 125 people were arrested for possession of bootleg cigarettes.

In this case, the informal-market cigarettes were sold to the public in rented warehouses and homes at a rate approximately half the price of the official market. Complicating matters, the Indian reservations in Canada are exempt from the law. In February 1994, this led to an actual shoot-out between the Indians and the government. At last, the Canadian government gave in and cut cigarette taxes in half. That put to an instantaneous end the more egregious aspects of informalism in the Canadian cigarette market.

How Consumers Respond

American cigarette taxes, at about 56 cents per pack, are among the lowest in the world (compared with the United Kingdom at $2.52, Canada at $3.01, and Denmark at $3.68).

The effect of the sin tax cannot be measured or predicted by its percentage of the overall retail price of the good or service. It must be measured by the way consumers respond to price changes, which differs from person to person. If demand is low, a high tax will have less startling effects in terms of creating underground markets. People will just give up the habit. On the other hand, if people would rather fight than switch, the social consequences of even a small tax are to induce informal entrepreneurs into the market.

History suggests that the demand for tobacco and liquor in the United States is probably very intense. Even relatively small changes in the tobacco tax at the state level have resulted in large-scale interstate smuggling.

As sensible as the reduction of the tax seems, anti-smoking groups in the United States immediately denounced the Canadian government for the change. These people had high hopes that the problems associated with Canada's high taxes were solely due to the discrepancy with the United States, a discrepancy that could only be remedied by vastly increasing the American tobacco tax. The Clinton administration proposed raising the tax to 75 cents per pack in 1994.

"Canada has been our greatest role model in demonstrating the effectiveness of tobacco taxes in preventing disease and premature death," said Cliff Douglas of the American Cancer Society in 1994. "We're using the Canadian data and experience heavily in our effort to persuade the United States Congress to follow suit by substantially raising federal tobacco taxes here."

Such policy would only make matters worse. Rather than ending the social chaos, it would merely export it to the United States. Tobacco would come across the borders at cheap prices one way or the other. Massive police power would have been expended to prevent leakage on both our Southern and Northern borders. Even that would not have prevented the inevitable growth of the underground.

Many Hurt by Sin Taxes

We find that any sin tax—whether a direct binary tax or a triangular tax that hits buyer and seller—is harmful in a number of ways.

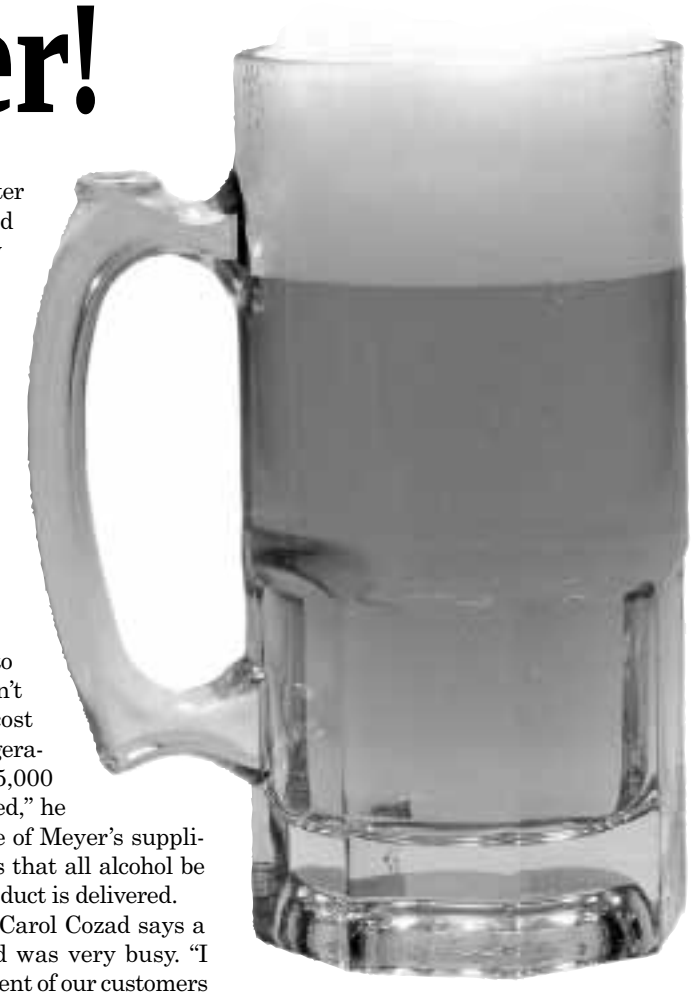
- It reduces the income of the buyer.
- It lowers profits for the seller, and leads to reduced investment, wages, and jobs.
- It is not likely to seriously discourage consumption habits when those habits are intensely desired.
- It may eventually decrease government revenue, especially as people move their business to the informal sector.
- It encourages people to turn to harder substances to feed their habits at the same price.
- It creates underground markets, which tend toward corruption and violence, and fosters disrespect for the law.
- It sets up a moral hazard for policy makers, who vacillate between wanting to discourage undesirable behavior and wanting to encourage it for revenue purposes.

Whatever economic or social benefits one can dream up from the sin tax, we must also realize that the decision to tax must be weighed against the social benefits for reducing the behavior by slow and deliberate persuasion and voluntary action. When it comes to public policy, the preferred method of discouraging sin should fall under the category of alternative institutions, especially family, church, and school.

Robert A. Sirico is president and cofounder of the Acton Institute for the Study of Religion and Liberty. His email address is **rsirico@acton.org.**

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Three Cheers for Beer!



by Stan Weinberg

Tolar, Texas just came off a very long dry spell in February, when voters approved the sale of off-premises beer and wine for the first time since the 1920s.

By a 91-58 vote, local voters made history on February 7 when they approved the sale of beer and wine in the city. Tolar had a 41 percent turnout for the referendum: 149 of 363 registered voters went to the polls.

Kay Marcum Pollock, who initiated the petition that led to the referendum, said, "I am very happy it passed. I think it's wonderful and a good beginning for change."

Billie Tramel, who, along with her husband Don, opposed the sale of alcohol in Tolar, said, "We weren't surprised the election went the way it did. But we were disappointed. We thought a lot more people would come out to vote against it. I guess they forgot or didn't care." Tramel said she believes even if the vote to sell beer and wine had failed, it would have come up again and probably would have passed eventually.

The vote attracted a response from former Tolar Mayor Gayle Meyer Gold, who several years ago failed in an attempt to get a petition passed calling for a referendum on the issue. "It's a good opportunity for Tolar to get ahead and earn new income. I think David's Super Market will come to Tolar and the revenues raised will help the city and won't be detrimental to the city," said Gold.

"Muy Bueno!"

On April 12, Meyer's Kwik Stop in Tolar added another reason—besides gas, coffee, and great cheeseburgers—to shop at the city's only convenience store: alcoholic beverages.

Kwik Stop owner Jay Meyer admitted, "I didn't think allowing the sale of beer and wine would pass, and then I didn't know if I wanted to sell it." Meyer said the reality that if he didn't sell alcohol, someone else would, helped him make up his mind. At least two retailers have already shown interest in opening stores in Tolar. (As for a major grocery store coming to town, David's, an area supermarket chain, declined to comment.)

Like Moses hitting a rock and water pouring forth, the flow of beer hasn't let up since Meyer began selling it.

Debra Nichols has worked at the store for about eight years. She's sold a lot of fast food, cigarettes, and lotto tickets, but she says none of that compares to the first carton of beer she sold. "We didn't sell a lot of beer the first day, but I'll always remember the 12-pack of Budweiser I sold to a lady from Tolar," she said.

Some old-timers believe the last time alcohol was legally sold in Tolar was in the 1920s. There were also several saloons in town in the late nineteenth century. Those who opposed the sale of alcohol in Tolar predicted it would lead to an increase in crime and a decrease in the town's small-town values.

Customers entering the Kwik Stop seem either surprised or happy as they look to the back of the store and see the vibrant display of beer company neon signs. Some ask, "What's different here?"

It doesn't take them long to see the ice box filled with case after case of domestic beer, wine coolers, and a number of exotic beers. Jose Rangel, a Mexican national and admitted long-time Kwik Stop customer, walked up to the counter with a 12-pack of Bud Light. "I didn't know you were selling beer," said Rangel with gusto, "but I think it's muy bueno!"

Nichols says when customers discover the store is carrying beer, they shout, "Yeah, now we don't have to go all the way to Granbury."

Investment Pays Off

Meyer says getting into the beer business wasn't cheap. "Besides the cost of installing the refrigerator, it took about $15,000 inventory to get started," he said. According to one of Meyer's suppliers, the state requires that all alcohol be paid for before the product is delivered.

Kwik Stop cashier Carol Cozad says a recent April weekend was very busy. "I believe about 100 percent of our customers on Friday and Saturday nights came in to buy beer," said Cozad. "During last week about half of the customers came in to buy beer," she smiled.

The sale of beer doesn't seem to adversely affect the sale of other items. "They buy chips and bread and other groceries along with the beer. I think they even buy more of those items than they did before we began selling beer," said Nichols.

Nichols said the Texas Alcoholic Beverage Commission (TABC) has already come by to make sure employees are asking for identification before selling alcohol. "We ask for identification from anyone who looks 36 years old or younger," said Nichols.

Cozad said most customers don't object to being asked for identification, but there are a few who do. "Some of our regular customers who are old enough to buy beer are insulted to be asked for identification, but that's the law," she said.

Stan Weinberg writes for The Hood County News*, in which this article first appeared on April 21. His email address is* **cowpoke@hcnews.com**.

Businesses Hurt by Smoking Ban in Oshkosh, Wisconsin

by Maureen Martin

On April 8, voters in Oshkosh, Wisconsin approved a referendum banning smoking in some restaurants and bars. The measure passed by the slimmest of margins: 50.7 percent supported the ban. Owners of area establishments are not happy, and their businesses have been hurt.

Unlike smoking bans adopted in some municipalities, such as Wilmette, Illinois, the ban in Oshkosh does not affect all restaurants and bars. In Oshkosh, if a restaurant or bar earns 70 percent or more of its gross revenues from the sale of alcoholic beverages, the owner may apply for an exemption from the smoking ban by submitting "certifications as to percentages of food sales versus liquor sales."

"This is Wisconsin," said Lisa Levine, co-owner since 1985 with her husband Phil of Jeff's on Rugby, an Oshkosh restaurant and bar, "the home of beer, brats, and cheese. We serve fatty meats and deep fried food at our restaurant. We serve alcohol. So when did we become a health club? "Am I supposed to tell a customer who orders dessert: You really should have a salad because you have a big [rear]?" Levine asked.

Economic Impact Comes Quickly

Since Jeff's on Rugby derives less than 70 percent of its gross revenues from alcohol, the establishment will not qualify for an exemption, Levine said. Already, the ban is having a substantial impact on their bottom line. "On Saturday [May 1], we closed down the bar at 10:30 p.m. for the first time in 19 years," Levine said, adding the last meal was served that night at 8:30 p.m.

"Levine and other restaurant-bar owners in Oshkosh are considering a legal challenge to the ordinance's constitutionality."

The smoking ban has hurt sales of alcoholic beverages, Levine said, just when the business was beginning to recover from the post-9/11 slump that has affected the economy generally. While 85 percent of the establishment's gross revenues come from food sales, 85 percent of the profits come from liquor sales, Levine said. She has already laid off a part-time waitress and a bartender, and she may lay off a dishwasher. She withdrew $2,500 from the family's savings to pay bills recently. "If people in this community don't think this is harming them economically, they're wrong."

Levine also said some competing restaurants with bars have been granted exemptions because they certified that food sales are less than 30 percent of their gross revenues. "Creative bookkeeping," she said.

Lawsuit Ahead?

The ordinance depends heavily on "junk science," said Levine, that claims second-hand smoke "is a leading cause of premature death and disability among non-smokers."

Moreover, Levine notes, the ordinance defines "smoking" very broadly, as "inhaling, exhaling, burning or carrying any lighted cigar, cigarette, pipe, weed, plant, or other combustible substance in any manner or in any form."

"Does that mean I can't light candles on tables in the dining room?" she asked.

Levine and other restaurant-bar owners in Oshkosh are considering a legal challenge to the ordinance's constitutionality. The group met with a lawyer in early May and is raising funds for the effort.

Maureen Martin is senior fellow for legal affairs with The Heartland Institute. Her email address is **martinlaw@charter.net**.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Tell Us What *You* Think!

Write to us at:

Budget & Tax News
The Heartland Insitute
19 South LaSalle Street #903
Chicago, Illinois 60603

Or drop us an email:
skorburg@heartland.org

Michigan House Approves Temporary Three-Year Cigarette Tax Hike

by Michael LaFaive

On May 26, the Michigan House of Representatives voted in favor of making the state's cigarette tax the nation's second highest, behind only New Jersey, on a temporary basis.

The Michigan House narrowly approved increasing the state tax on a pack of cigarettes from $1.25 to $2 as part of a plan to balance the state budget in House Bill 5632.

The "as passed" legislation was different from that proposed earlier by Governor Jennifer M. Granholm (D) in two ways: The House bill excluded a 60 percent increase (on the 20 percent markup) on the wholesale price of "other tobacco products" (cigars and smokeless tobacco), and the cigarette tax hike was limited to a three-year period. The governor's plan would have made the tax permanent and included smokeless tobacco products and cigars.

In a sarcastic response to the legislation, State Representative John Garfield (R-Oakland County) introduced an amendment to raise the cigarette tax to $10 per pack. "We should not be trying to balance our state budget on a bad habit. Rather, government should try kicking its bad habit of spending beyond its means," he said. The amendment was not seconded and never brought to a vote.

The vote on HB 5632 came less than a week after the body entirely rejected a cigarette tax hike proposal, approving instead $266 million in spending cuts to help balance the state budget.

If enacted, the cuts would affect all departments of state government except the Michigan Department of Transportation. Among other cuts, public universities and community colleges would receive $90 million less than a year ago; Medicaid funding for caretaker relatives was cut $42 million; "Merit Awards" would go only to students with a "C" average or better, saving $20 million; and arts grants were cut by $10 million. The Merit Awards, scholarships for top students going to college, are funded by the national tobacco settlement.

While state legislators on the House side did not accept the governor's call for higher taxes on smokeless tobacco products, state senators may reinsert the proposal when the Senate takes up the legislation.

Some reports indicate Granholm has bipartisan support for that move. But the *Detroit Free Press* reported on May 30, "Senate Republicans said Thursday [May 27] they won't vote for the cigarette tax increase unless GOP legislation aimed at creating jobs is included in the deal. Republicans are pushing a number of bills they say will create new jobs and promote a more business-friendly climate within the state."

"We should not be trying to balance our state budget on a bad habit. Rather, government should try kicking its bad habit of spending beyond its means."

HON. JOHN GARFIELD
MICHIGAN STATE REPRESENTATIVE

Tax Effects on Health

Many proponents of tobacco tax hikes have argued taxing smokers would improve their health by discouraging tobacco use. But evidence also suggests cutting taxes on smokeless tobacco could achieve health gains.

"Lowering taxes on smokeless tobacco to encourage smokers to switch from cigarettes to smokeless tobacco is a legitimate harm reduction strategy," said Joe Lehman, executive vice president of the Mackinac Center for Public Policy.

Manufacturers of smokeless tobacco say their newer products can be used discreetly in social situations and still provide high levels of satisfaction to former cigarette users. Some studies show smokeless tobacco is much safer than the combustible forms.

Brad Rodu, professor of pathology at the University of Alabama at Birmingham, is an expert on smokeless tobacco usage and has studied the product's effects on cancer rates and mortality.

Rodu found a link between the high rates of smokeless tobacco use among Swedish men and their relatively low lung cancer rates—the lowest among 20 European countries studied. Other evidence has been cited by Rodu in testimony before Congress. For example:

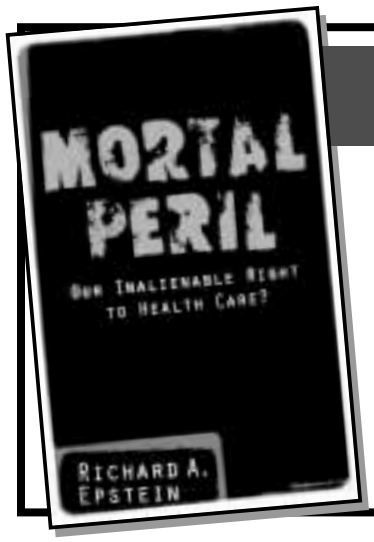
- In 2002, the British Royal College of Physicians, a prestigious medical society, published "Protecting Smokers, Saving Lives," which estimated smokeless tobacco products are less hazardous than smoking, depending on the product; and
- A 1998 study published in the *American Journal of Medicine* reported 25 percent of "inveterate" smokers (people who tried but failed repeatedly to quit smoking) were able to successfully switch from smoking cigarettes to smokeless tobacco products.

"If officials care about the health of Michigan's tobacco users and aren't just looking for an easy target for a tax increase, cutting taxes on smokeless tobacco is a sound option," said Lehman.

"Just for the health of it, lawmakers should quash the tax increase and repeal existing taxes on smokeless tobacco," Lehman said.

The Senate had not acted on the budget proposal as this issue of *Budget & Tax News* went to press. Michigan's fiscal year begins July 1.

Michael LaFaive is director of fiscal policy at the Mackinac Center for Public Policy. His email address is **lafaive@mackinac.org**.



Order Your Copy of *Mortal Peril* Today!

"Richard Epstein is one of the most important and wide-ranging legal scholars in America. I have always found it crucial to read him. Even if we ultimately reach different conclusions, having to grapple with the Epstein point of view always greatly enhances my own appreciation of the issues. I thoroughly enjoyed Mortal Peril."

PAUL WEILER
HARVARD LAW SCHOOL

Mortal Peril - 503pp., $27.50

Order your copy today!

Contact The Heartland Institute at 312/377-4000, or order from the Heartland store at **www.heartland.org**

The Heartland INSTITUTE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Activity

Continued from page 1

enue officials in the Garden State wanted nearly $600 in corporate taxes and fees from Horne for selling software to a customer in New Jersey. The state also wanted $600 every year so long as Horne's customer continued to use the software. Horne was puzzled, since neither he nor his business had ever set foot in New Jersey.

"No small business can pay $600 in taxes and fees just for the privilege of participating in interstate commerce with a state," Horne said.

Debate Launched Decades Ago

Congress tried to put an end to states' efforts to intrude on interstate commerce in the late 1950s by passing Public Law 86-272, the Interstate Income Tax Act of 1959. The law said a business was not liable to pay state taxes merely because it made sales of tangible personal property in a particular state.

The law was passed in response to a U.S. Supreme Court decision in *Northwestern States Portland Cement Co. v. Minnesota*, where the Court held the state of Minnesota could levy taxes on a business's net income solely because of sales made to customers in the state. The Supreme Court did not require a physical connection to the state in order to trigger business taxation, so Congress responded by enacting the first federal restrictions on state tax authority in U.S. history.

Since 1959, commerce has become increasingly interstate and even international in scope. Friction is growing between business owners like Horne and state revenue officials, who fear the federal government will act again to prevent them from taxing business activity in their states.

Business leaders warn recent aggressive tax actions by state revenue departments will have a harmful effect on the economy. They say the same principle that led Congress to adopt P.L. 86-272 in 1959 applies to the new economy as well.

"One of our nation's founding principles that still resonates today is 'no taxation without representation.' But this concept of paying taxes in the jurisdiction where the business actually receives benefits and services is in danger of being eroded in some states," said Mike DiConti, who works with the Business Roundtable.

HR 3220 Would Set Limits

HR 3220, the Business Activity Tax Simplification Act of 2003, introduced by Representatives Bob Goodlatte (R-Virginia) and Rick Boucher (D-Virginia) on October 1, 2003, would limit efforts by states to tax business activity originating outside their borders. The measure currently has 30 cosponsors.

HR 3220 would codify the physical presence standard for state taxation of business activities. The measure also would extend that protection, which currently applies only to the sale of tangible personal property, to the sale of services and intangibles as well.

Commenting on the bill's introduction, Boucher said, "(N)o clear standard exists to define the taxation of business activity by the states. This uncertainty has allowed several states to impose unfair taxes onto businesses ... The Business Activity Tax Modernization Act would rectify the unfairness which currently exists by setting a physical presence nexus standard."

State and Local Taxers Oppose Bill

HR 3220 was heard in the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee on May 13, 2004. Several groups representing state or local governments, including the National Governors Association (NGA), National League of Cities (NLC), and Multistate Tax Commission (MTC), condemned the bill.

Rick Claybaugh, from the North Dakota Office of State Tax Commissioner, testified on behalf of the NGA, saying, "The NGA opposes HR 3220 because it would unduly interfere with the ability of states to determine and manage their own tax policies. Most importantly, HR 3220 runs directly counter to our system of federalism and places Congress in the position of making decisions that for over 225 years have been reserved to state and local elected officials."

NLC claimed HR 3220 would cause state and local governments to "lose more than $60 billion annually in revenues." When confronted with the fact that state and local governments collect less than $60 billion per year in total corporate income taxes, NLC changed its statement to assert that a "substantial portion" of the $60 billion would be lost.

The MTC contends bills like HR 3220 are contrary to federalism and state sovereignty. Maryland Deputy Comptroller Stephen Cordi said, "(H.R. 3220) runs roughshod over federalism by imposing from above a substantial number of federally mandated state tax exemptions overriding hundreds of existing state and local laws and rules."

"(HR 3220) would send the message that the widely criticized style of income shifting associated with WorldCom and Tyco in order to avoid state taxes is just fine with Congress," said Norris Tolson, North Carolina Secretary of Revenue. "The inevitable surge in opportunistic tax sheltering would create new state revenue shortfalls in 40 states—and more in New York City and other cities around the U.S. This new epidemic of tax sheltering would put a further crimp on essential services such as education, transportation, and infrastructure at a time of already historic state budget shortfalls."

Consistent with Federalism

One of the witnesses at the hearing, Iowa State Representative Jamie Van Fossen (R-Davenport), testified in support of HR 3220 saying it is consistent with federalism and would be good for state and local governments.

"Federalism, like the separation of powers, is a tool we use to limit government's power and enhance the liberty of our citizens," Van Fossen said. "Whenever state government goes beyond the powers given to it by the people and the Constitution, such as when a state tries to impose taxes on businesses located outside its jurisdiction, we should not hide behind the mantra of federalism and excuse such action."

Van Fossen also took issue with claims HR 3220 would cause state revenue loss. "(Congress is) not forced, as the opponents of this bill claim, to choose between public schools and corporate profits," said Van Fossen. "Rather, (Congress is) going to decide whether federalism is a two-way street, granting license to states as well as restricting state power outside its own borders. Enacting legislation like HR 3220 is the best medicine Congress can prescribe for healthy state economies."

Art Rosen, testifying for the Coalition for Fair and Rational Taxation (CRAFT), said the federalism and state sovereignty concerns of NGA (and other state groups) were misguided. "Legislation regarding states and localities imposing, regulating, or removing tax burdens placed on transactions in interstate commerce is not only within Congress' realm of authority, it is also—I respectfully submit—Congress' responsibility."

Debate Expected to Continue

While questioning at the hearing was sparse, it appeared likely the business activity tax will get caught up in the debate over two other state tax issues in Congress: the Internet Tax Moratorium and the Streamlined Sales Tax Project.

While Congress plays politics with state tax policy and interstate commerce, it remains unclear whether small business owners like Horne will ever get the green light to resume full participation in the American economy.

Chris Atkins is director of tax and fiscal policy for the American Legislative Exchange Council. His email address is **cdatkins@alec.org**.

HR 3220, The Business Activity Tax Simplification Act of 2003

Iowa State Representative
Jamie Van Fossen (R-Davenport)

"Whenever state government goes beyond the powers given to it by the people and the Constitution, such as when a state tries to impose taxes on businesses located outside its jurisdiction, we should not hide behind the mantra of federalism and excuse such action."

Norris Tolson
North Carolina Secretary of Revenue

"(HR 3220) would send the message that the widely criticized style of income shifting associated with WorldCom and Tyco in order to avoid state taxes is just fine with Congress."

INTERNET INFO

The full text of HR 3220 is available through *PolicyBot*™, The Heartland Institute's free online research database. Point your Web browser to **http://www.heartland.org**, click on the *PolicyBot*™ button, and search for document **#15186**.

The text of testimony presented at the May 13 hearing is also available through *PolicyBot*™. Search for documents **#15187** (Arthur R. Rosen, 17 pages), **#15188** (Hon. Jamie Van Fossen, 3 pages), **#15189** (Rick Clayburgh, 3 pages), and **#15190** (Vernon T. Turner, 4 pages).

A webcast of the hearing on is available at **http://boss.streamos.com/real/hjudiciary/commercial/com051304.smi**

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

BAT Proposed for Ohio

by John Skorburg

In May 4 testimony to the Ways & Means Committee of the Ohio House of Representatives, the president of the Dayton-based Buckeye Institute for Public Policy Solutions expressed support for, but also reservations about, a proposed new Ohio business activity tax (BAT).

Under an April 15 proposal, the Ohio corporate franchise tax and tangible personal property tax would be eliminated and replaced with a Business Activity Tax, which would be Ohio's sole corporate tax. The proposed BAT base is a weighted combination of three components: a company's sales in Ohio (60 percent), property (20 percent), and payroll (20 percent). Under the proposal, which would take effect in 2006, the tax rate would be approximately .71 percent.

Sam Staley, president of the Buckeye Institute, noted several reasons why the BAT under consideration in Ohio could be a positive reform measure. He noted,

- The proposed tax would be based on the net book value of corporate property, allowing for depreciation and amortization to reflect the true economic value of the business.
- The BAT would be a substitute tax, not another tax added on to the state's current corporate tax system.
- The proposal provides an income tax credit for owner-operator businesses, avoiding inequities between small (often subchapter S) firms and large firms.
- The BAT helps make the state's tax system more equitable by adopting a broader base.

Concerns, Too

While generally supportive of the BAT proposal, Staley expressed concern as well.

"We need to be moving forward on creating a more competitive tax structure as well as reducing taxes overall in order to improve the state's business climate. This is a valuable step toward starting a broader public debate on structural tax reform."

SAM STALEY, PRESIDENT
BUCKEYE INSTITUTE FOR PUBLIC POLICY SOLUTIONS

"The most significant concern with a BAT," he testified, "may be the potential to substantially increase the tax burden. This potential exists because of a lack of transparency in its calculation. The base is not immediately obvious, requiring the addition of different components of business operations.

"This lack of transparency could allow policymakers to increase the tax rate in the future to generate higher tax revenues. Ohio's direct experience with the income tax has created legitimate skepticism about new tax proposals and their potential to increase the overall tax burden over time. Although the BAT proposes a flat tax rate of 0.71 percent, the rate could easily increase, or become graduated, without some sort of constraint," Staley continued.

According to Staley, the potential for using a BAT as a "stealth" tax increase could be eliminated if a tax and expenditure limitation, or TEL, were included as part of the reform package.

"A TEL could easily be modeled on Colorado's successful initiative, limiting the growth of government spending on the state and local level to a fixed rate such as the inflation rate or personal income growth. All surplus revenues over a certain amount would be rebated to taxpayers, and multi-year surpluses could trigger permanent tax cuts," Staley explained.

A TEL, Staley noted, would also be politically popular: "A poll of Ohio citizens by The Buckeye Institute found that 78 percent would favor a proposal to limit the rate of government spending growth to the inflation rate.

"Regardless of the potential pitfalls," Staley continued, "I applaud the committee for taking up the issue of fundamental tax reform.

"Ohio currently has one of the highest state and local tax burdens in the nation. We need to be moving forward on creating a more competitive tax structure as well as reducing taxes overall in order to improve the state's business climate. This is a valuable step toward starting a broader public debate on structural tax reform."

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

INTERNET INFO

For more information visit the Buckeye Institute Web site at **http://www.buckeyeinstitute.org**.

International Society for Individual Liberty

We at ISIL are proud to be the primary sponsor of the Adventures of Jonathan Gullible project, which has seen this prize-winning book/fable translated into over 30 different languages around the world. ISIL and its network of members in over 90 countries pursue the goal of individual liberty through educational and networking activities.

ISIL literature & activities include:

- *Freedom Network News newsletter/magazine.*
- *Educational Outreach Pamphlet Series.* 40+ titles on a wide variety of current topics – includes 18 translations into Spanish (over 4 million distributed across America).
- *World-class websites.* **www.isil.org** – a rich source of research materials, and **www.Free-Market.net** – the #1 libertarian portal to the Internet.
- *World Conferences.* Since 1982, ISIL has organized annual world conferences which have served as a catalyst for the development of the world libertarian movement.

Join ISIL today for $35US a year & receive a subscription to the Freedom Network News and a full set of educational pamphlets (or send $5US for an information package).

The Adventures of Jonathan Gullible: A Free-Market Odyssey in Urdu, the language of Pakistan and many countries in south Asia. This is the 32nd language in which this amazing book has been published.

836-B Southampton Rd. #299, Benicia, California 94510-1960 USA; Tel: +(707) 746-8796 Fax: +(707) 746-8797
E-mail: **isil@isil.org**; World Wide Web: **www.isil.org • www.free-market.net**

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Let Markets Decide Where Wal-Mart Goes

by Edwin A. Locke

How would you like to be penalized because you do your work too well—for example, running your business so effectively that it attracts hordes of happy customers? Well, this is what is happening more and more frequently to Wal-Mart.

Recently the West Covina, California City Council voted to deny the sale of land to developers who were going to build a Wal-Mart store on the site. The Chicago City Council decided to allow Wal-Mart to build one of two stores on Chicago's West and South Sides.

Wal-Mart is one of the most impressive success stories in the history of business. Founded some 50 years ago as a single five-and-dime store in a small Arkansas town, it has grown into a worldwide behemoth. It is the largest corporation in America in terms of sales, $245 billion in 2003. Wal-Mart has 3,586 stores in the U.S. and employs 1.2 million U.S. workers, 42,000 in Illinois.

It is true that Wal-Mart has been successful in out-competing other stores that sell the same products, such as toys, clothing, and groceries. But how has it been able to do this? By discovering new ways of using computer systems and other technology to better manage its inventory and costs and reap the benefits of economy of scale.

Wal-Mart is popular among low-income shoppers who cannot afford the prices of the more upscale stores. It has put other stores out of business, but that is the way capitalism works. The automobile replaced the horse and buggy. Sound motion picture replaced the silents. No one has a "right" to business success or a "right" to be protected from competitors through government intervention. One only has a right to try to compete through voluntary trade. In a free economy, companies that offer the best value for the dollar win and the losers invest their money elsewhere.

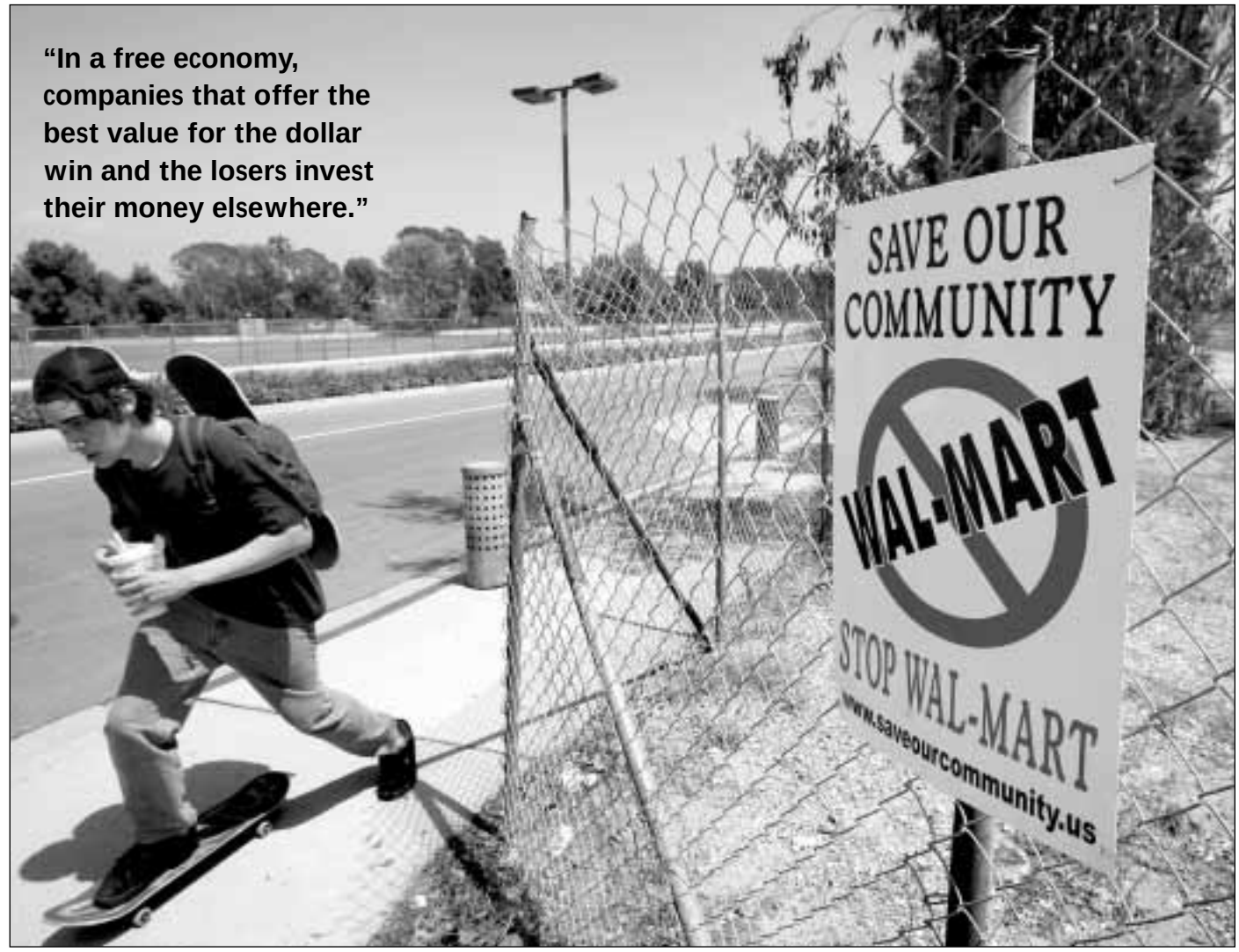
It is also true that Wal-Mart pays lower wages than many unionized stores. But it must offer a market wage or risk its employees going elsewhere, and it deals with employees on a voluntary basis. Those who do not like its terms are free to do business elsewhere. This makes the company especially hated by organized labor, such as the grocery unions. By coercively restricting the supply of labor, these unions, backed by government laws and regulations, have been able to extort wages and benefits far above those that would exist in a truly free labor market. In a free market, how many people doing relatively unskilled work would get $17 to $19 per hour plus full medical benefits? Unions, of course, have the right to organize and picket ... but not to benefit from government regulations that give them special favors. No one has the right to dictate what a company offers to pay others.

There is only one morally proper way to keep Wal-Mart out of any community: Don't patronize its stores. If Wal-Mart cannot make money in a given location, it will either not move there or it will close the store. So far, however, it makes money everywhere it opens a store for one simple reason: People want to shop there. The low prices Wal-Mart offers make people wealthier. They can buy a wide range of goods that they could not otherwise afford and they can use the money they save for other purposes.

Local government officials should not be allowed to abuse their power by keeping out stores that people want to shop in. Nor, of course, should Wal-Mart be allowed to use eminent domain laws, as it is trying to do in several states, to force property owners to sell their land. But provided it refrains from using eminent domain, we should welcome every store that Wal-Mart builds. We should thank Wal-Mart for being so good at giving people what they want that Wal-Mart can make huge profits, which enables the company to build more stores, hire more employees, give more profit opportunities to suppliers, and make even more customers happy.

Wal-Mart should not be feared but should be admired as an American ideal—a classic rags-to-riches story. Trying to stop Wal-Mart is not only morally wrong, it is un-American.

Edwin A. Locke is a senior writer for the Ayn Rand Institute. He can be reached at **http://www.edwinlocke.com/**. *This essay was first published on May 25, 2004 by the* Chicago Sun-Times.


"In a free economy, companies that offer the best value for the dollar win and the losers invest their money elsewhere."
SAVE OUR COMMUNITY
WAL-MART
STOP WAL-MART
www.saveourcommunity.us

Getty

A skateboarder passes a sign reflecting local opposition to plans by retail giant Wal-Mart to build a superstore on the site shown April 15, 2004 in Rosemead, California.

City Council Approves Chicago's First Wal-Mart

by John Skorburg

On May 26, the Chicago City Council voted in favor of one Wal-Mart construction proposal but against another, approving on a 32-15 vote a store for the west side Austin neighborhood but rejecting by a single vote a store for the south side Chatham neighborhood.

"Somebody's out there waiting on that first opportunity, " said Ald. Emma Mitts (37th Ward) about gaining the Wal-Mart store for her neighborhood. Reported the *Chicago Sun-Times*, "residents of her West Side ward are crying out for jobs and shopping choices."

Politics killed the proposal for the south side Wal-Mart. "To the extent that I did not come to my colleagues and ask them for their individual support, I have apologized for that," said Ald. Howard Brookins (21st Ward) after his defeat. Ald. Ed Burke (14th Ward), powerful chairman of the council's finance committee, was quick to give Wal-Mart a second chance by re-referring the request to the Zoning Committee.

Noted Brookins, "It's a temporary setback. It goes back to committee and we start all over. It's not dead."

Protestors jammed the second floor of City Hall before the Wal-Mart vote, demanding the company offer its employees a living wage.

Mitts responded to the protestors, "I started out at $4 a day—not an hour. I had an opportunity to keep elevating. ... Those are opportunities you keep grabbing hold of in life."

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Key Economic Concepts for Policymakers and Business Leaders

by Tom Walton

This is the first in a series of columns on economics for policymakers and business leaders.

Opportunity Cost and Trade-offs: The true cost of any spending or investment decision is the cost of the foregone opportunity, or what could have been bought or the return on the investment that would have occurred if a different decision were made. For example, the opportunity cost of building a parking lot on a vacant lot in downtown Chicago is the revenue foregone from building another skyscraper. Every government regulation, tax, and spending program imposes opportunity costs on businesses and consumers. It's been estimated the opportunity costs associated with cost-ineffective federal regulations and programs—the costs of failing to spend the moneys more wisely and effectively—amount to 60,000 lost lives per year.

Marginality: It is the marginal, not the average, behaviors of buyers and sellers that determine the prices at which goods are bought and sold. For example, marginal tax rates, not average tax rates, determine the effects of changes in the tax code. And it is the response of the marginal buyers and sellers that determines the impact of an increase in the price of an automobile or a gallon of gasoline.

Rationality: The best way to understand, explain, and predict economic behavior is to assume consumers and sellers are rational. Everyone does not have to be rational: The concept of marginality says we need only assume the marginal buyers and sellers are rational. Economists have found this assumption holds even in mental asylums. The debate over whether or not to raise Corporate Average Fuel Economy standards, for example, always seems to come down to whether policymakers view consumers as rational: In the absence of net negative externalities (see below), rational consumers in competitive markets do not need to be told what to do.

Externalities: These are opportunity costs not fully accounted for by the market system. Negative externalities are costs (e.g., pollution from cars and trucks) borne by others, while positive externalities are benefits (e.g., the economic and social benefits created by greater personal mobility) the owner or producer of a good does not get paid for. Government regulations also impose externalities, both negative and positive. For example, the government's economic analysis of the recent increase in the fuel efficiency standard for light trucks showed the negative externality—safety and congestion costs—imposed by the increase exceeded the externality benefits by a factor of 4 to 1.

The First Law of Demand: All else equal (holding all other economic variables such as personal incomes, the prices of other goods, demographics, and personal tastes unchanged), an increase in the price of a good will result in a reduction in the quantity of that good demanded.

Elasticity of Demand and Supply: The responsiveness of consumers and producers to small changes in prices or regulatory costs is very important in the assessment of the impact of regulatory, tax, trade, and other government policies, as well as to business and personal planning. For example, all else equal, a 10 percent increase in gasoline prices translates into a one-year reduction in the demand for gasoline of 1 percent, growing to a 5 percent reduction if the price increase is sustained over a period of five years.

Equilibrium: The point at which the supply of a good equals the demand for it. Prices and profits make markets trend toward equilibrium, since shortages lead to higher prices, greater profits, and more supply, while surpluses lead to lower prices, lower profits, and less supply. Equilibrium is a concept useful for analysis because it directs attention to government policies that interfere with market processes. Shortages are invariably the result of government interference. For example, the gasoline queues following the OPEC oil embargo in 1973 were caused by fuel price controls. The U.S. was the only nation with such queues because it was the only nation with price controls.

The Equal Marginal Principle: Welfare or utility is maximized for individuals and for society if the value of each dollar spent is the same for all items on which the dollar is spent. This principle, together with the assumption of competitive markets and markets free of externalities, implies the following theorem.

The First Theorem of Welfare Economics, also called "The Invisible Hand Theorem" of Adam Smith: The allocation in a competitive equilibrium in which all externalities are internalized is economically efficient—that is, societal total net benefits (total costs less total benefits) are maximized. This theorem has numerous implications for public policy analysis, including:

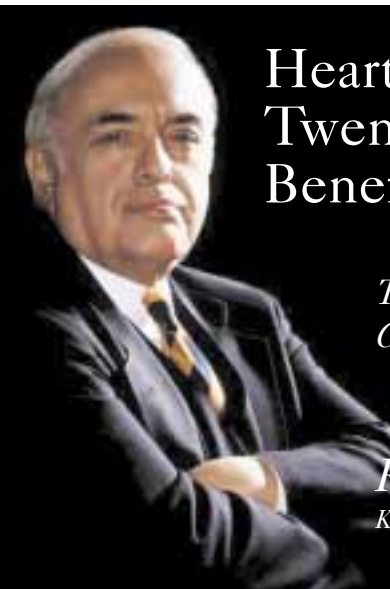
- In order to justify a regulation, tax, or other interference with a market or economy, there must first be a showing that the market is not "competitive" or there are externalities that individual buyers and sellers fail to take into account.
- The level of stringency for any government regulation or tax that maximizes societal net benefits is the point at which the marginal social benefit of such a tax or regulation equals its marginal social cost. These first two principles are embedded in the President's Executive Order 12866 for regulatory analysis (established under President Clinton).
- Price controls (e.g., minimum wages, agricultural price supports, gasoline price controls) necessarily harm a competitive economy.

The Power of Compound Interest: Earnings have greater long-term productivity the earlier they are reinvested. For example, a thousand dollars invested today at the historical (last 75 years) and current real or inflation-adjusted compound annual rate of return on U.S. government notes, or 2 percent, would grow to $2,692 dollars after 50 years. If it were invested at the historical 7 percent per year compound real return on stock market investments, it would grow to $49,457. This disproves Karl Marx's labor (only) theory of value. Some believe Einstein once remarked this is the most powerful insight in all of mathematics.

The Theorem of Comparative Advantage: "Whether or not one of two regions is absolutely more efficient in production of every good than is the other, if each specializes in the products in which it has a comparative advantage (greatest relative efficiency), trade will be mutually profitable for both regions and real wages of [workers and other] productive factors will rise in both places." (From Paul Samuelson, *Economics*, Sixth Edition.)

The Accounting Identity that Determines a Nation's Balance of Payments: The external trade deficit (imports less exports) is identically equal to the sum of the government budget deficit (or the excess of government expenditures over receipts) and the excess of private domestic investment over private domestic savings. Together with the theorem of comparative advantage, this identity is useful to rebut the common wisdom that exports are better for the economy than imports and that the trade deficit is the result of a deficit in any particular sector such as autos or oil. Rather, the current U.S. trade deficit is caused primarily by government budget deficits, high rates of return on foreign (direct) investments in U.S. businesses such as auto transplant facilities, and Asian bank purchases of U.S. government securities, especially by China and Japan.

Tom Walton is an economist with General Motors in Detroit and a member of the Board of Directors of The Heartland Institute. He can be reached by email at **think@heartland.org**.



Heartland's Twentieth Anniversary Benefit Dinner

Thursday, September 23, 2004
Chicago Hilton Hotel

Robert Novak
Keynote Address

Illinois native Robert Novak will deliver the keynote address at Heartland's twentieth anniversary benefit dinner on Thursday, September 23, 2004, at the Chicago Hilton Hotel.

Novak is a nationally syndicated columnist and host and co-executive producer of CNN's political roundtable, "Capital Gang." He is also an occasional co-host on CNN's "Crossfire" program and often appears as an interviewer on NBC's "Meet the Press."

Novak will be joined by *Wall Street Journal* editorial writer John Fund, Heartland Founder and Chairman Emeritus Dave Padden, and Heartland President Joseph Bast. Tickets and table reservations are now on sale.

For more information call The Heartland Institute at 312/377-4000 or visit Heartland's Web site at www.heartland.org.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

A Special Offer for Advertisers!

Want to Reach Every State and Federal Elected Official?

TAX WATCH
Budget&Tax News
Schwarzenegger Faces Toxic Tax System
How Washington State Balanced Its Budget
Taxes, Education Clash in Nevada

Cheaper than direct mail and far more effective!

Advertise in *Budget&Tax News*.

Act now to take advantage of this special introductory offer: Buy any size ad and get the following issue FREE!

Size:	BW	Color
Full Page	$1,050	$1,683
Junior Page	$820	$1,453
Half-page	$610	$1,243
Quarter-page	$350	$983

Every month *Budget & Tax News* is sent to all 8,300 of the nation's state and federal elected officials, plus 1,630 journalists and some 3,000 subscribers, Heartland Institute members and donors, and allies.

This is the perfect place for legislators to see your message!

For more information please call Nikki Saret at 312/377-4000, email nikki@heartland.org

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED